NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

Congressional Information Service, Inc
Washington, D.C

S. Hrg. 100-165

MOSS TALKS/U.S. AUTO PARTS INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON
EMPLOYMENT AND PRODUCTIVITY

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

EXAMINING MARKET-ORIENTED, SECTOR SPECIFIC (MOSS) TALKS BETWEEN THE UNITED STATES AND JAPAN AND THEIR EFFECT ON U.S. EMPLOYMENT IN THE AUTO PARTS INDUSTRY

MARCH 30, 1987

Printed for the use of the Committee on Labor and Human Resources

U.S. GOVERNMENT PRINTING OFFICE
75-650 WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S541-37

COMMITTEE ON LABOR AND HUMAN RESOURCES

EDWARD M. KENNEDY, Massachusetts, *Chairman*

CLAIBORNE PELL, Rhode Island
HOWARD M. METZENBAUM, Ohio
SPARK M. MATSUNAGA, Hawaii
CHRISTOPHER J. DODD, Connecticut
PAUL SIMON, Illinois
TOM HARKIN, Iowa
BROCK ADAMS, Washington
BARBARA A. MIKULSKI, Maryland

ORRIN G. HATCH, Utah
ROBERT T. STAFFORD, Vermont
DAN QUAYLE, Indiana
STROM THURMOND, South Carolina
LOWELL P. WEICKER, Jr., Connecticut
THAD COCHRAN, Mississippi
GORDON J. HUMPHREY, New Hampshire

Thomas M. Rollins, *Staff Director and Chief Counsel*
Hayden G. Bryan, *Minority Staff Director*

Subcommittee on Employment and Productivity

PAUL SIMON, Illinois, *Chairman*

TOM HARKIN, Iowa
BROCK ADAMS, Washington
BARBARA A. MIKULSKI, Maryland
EDWARD M. KENNEDY, Massachusetts (ex officio)

GORDON J. HUMPHREY, New Hampshire
ORRIN G. HATCH, Utah
DAN QUAYLE, Indiana

William A. Blakey, *Counsel*
Charles T. Carroll, Jr., *Minority Counsel*

CONTENTS

STATEMENTS

MONDAY, MARCH 30, 1987

Beckman, Steve, international economist, International Union, United Automobile, Aerospace and Agriculture Implement Workers of America (UAW), prepared statement 132
Bowden, Bruce K., vice president, marketing and product development, Stant, Inc., Connersville, IN, accompanied by William A. Thornton, director of original equipment sales; Elliot Lehman, co-chairman, FEL-PRO Incorporated, Skokie, IL, and John Riess, group vice president, Gates Rubber Company, Denver, CO 39
  Prepared statement of:
    Mr. Bowden 42
    Mr. Lehman 50
    Mr. Riess 58
Kaptur, Hon. Marcy, a Representative in Congress from the State of Ohio; and Hon. Sander M. Levin, a Representative in Congress from the State of Michigan 70
  Prepared statement of:
    Ms. Kaptur 74
    Mr. Levin 82
Nissan Motor Manufacturing Corporation U.S.A., prepared statement 137
Quayle, Hon. Dan, a U.S. Senator from the State of Indiana, prepared statement 18
Simon, Hon. Paul, a U.S. Senator from the State of Indiana, prepared statement 3
Smart, Hon. Bruce, Under Secretary of International Trade, U.S. Department of Commerce 20
  Prepared statement 22
Warren, Alex, Jr., vice president, administration, Toyota Motor Manufacturing USA, Inc., Lexington, KY, accompanied by Jeff Smith, liaison manager.. 95
  Prepared statement 97

ADDITIONAL MATERIAL

Articles, publications, etc.:

  The MOSS talks and their effect on employment in the U.S. auto parts industry—Background material of Senator Simon 9

MOSS TALKS/U.S. AUTO PARTS INDUSTRY

MONDAY, MARCH 30, 1987

U.S. SENATE,
SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY,
OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The Subcommittee convened, pursuant to notice, at 2:07 p.m., in room SD-430, Dirksen Senate Office Building, Senator Paul Simon (chairman of the subcommittee) presiding.

Present: Senators Simon and Quayle.

OPENING STATEMENT OF SENATOR SIMON

Senator SIMON. The subcommittee hearing will begin.

We are holding hearings on the U.S. auto parts industry and specifically our relationship with Japan in that area.

The trade deficit with Japan last year was $58.6 billion. There are a number of issues between the United States and Japan, but one of the important ones is the auto parts area.

I called this hearing to examine the U.S. auto parts industry and the Market-Oriented, Sector Specific, or so-called MOSS, talks, the last round of which was recently concluded here in Washington.

These talks, in progress since last August, are attempting to better the relationships between U.S. parts manufacturers and the Japanese auto industry and reduce the $3 billion plus deficit in auto parts.

On the plane coming here this afternoon, I read one account where someone said the United States penetration in the Japanese auto parts market would be very slow, very gradual; Japanese penetration in the United States would be very dramatic. I hope that is not the case.

We heard earlier in this Subcommittee some fairly staggering statistics in the employment factor in this country.

I want to particularly commend two witnesses who we will hear from a little later on—my House colleagues, Congresswoman Marcy Kaptur and Congressman Sandy Levin, for their leadership in this whole area.

There is no question that part of the problem is self-inflicted, through our Federal budget deficit. And let me note that starting tomorrow, we are going to be marking up the budget. And I think one of the measures of whether the United States Congress is serious about the trade deficit is whether we treat seriously the budget deficit. There appears to be a real reluctance to tackle the kind of problems that we face.

I will enter a full statement in the record, and add just a couple of other comments.

I had a meeting I guess about three weeks ago with Mr. Makoto Kuroda, the Vice Minister of the Ministry of International Trade and Industry, Mr. Smart's counterpart in the MOSS talks. It was a very candid discussion. I asked him to appear here today so that the Japanese viewpoint would be represented. He declined and said it might cause some confusion if he were to appear here today.

A few statistics very quickly. Employment in the auto part industry in the United States was 734,000 in 1978. It was down to 562,000 by 1983. The deficit in auto parts trade—this is the total deficit and includes Germany and other countries—was $5.86 billion in 1986; with Japan, approximately $3.8 billion.

At this point, less than one percent of the Japanese market is penetrated by U.S. auto parts.

The one report I had also said that there is a reluctance on the part of Japan to admit U.S. auto parts because of community feeling. I have great respect for our friends in Japan. They have done a remarkable job. They also have to understand there is community feeling also in the United States about what is happening here.

One other point I should mention, and that is I think we also have to take a look at the Foreign Trade Zone legislation, and I see you are making a note there, Mr. Smart. There is at least a possibility that we are creating some problems for ourselves with the present legislation.

Let me stop there.

[Senator Simon's prepared statement and background material follow:]

PREPARED STATEMENT OF SENATOR SIMON

The United States' trade relationship with Japan, while not its largest, has certainly gained the most attention over the past several years. Our current services account with Japan has mushroomed into a $58.8 billion deficit. While many of the earlier trade difficulties our country experienced have been removed, some still remain.

The Kansai International Airport is one such issue. This multi-billion dollar public works project is currently being contracted out almost exclusively to Japanese firms. Many have raised the valid point that since Japanese construction firms regularly contract in the United States, why can't our firms contract there?

Another issue is that of semiconductors. Allegations of dumping by Japanese firms have been in the press recently and Japanese manufacturers are beginning to place restraints on themselves, fearful of Congressional retaliation.

Self-imposed restrictions have also been used in the automobile industry. The Voluntary Restraint Agreements (VRAs) have limited the number of autos exported to the United States since 1981.

I have called this hearing to examine the U.S. auto parts industry and the Market-Oriented, Sector Specific (MOSS) talks, the last round of which was recently concluded here in

Washington. These talks, in progress since last August, are attempting to better the relationships between U.S. auto parts manufacturers and the Japanese auto industry and reduce the $3 billion plus deficit in auto parts.

I wish to explore the experiences of U.S. auto parts makers in selling their products to the Japanese, both here and in Japan. I am also interested in the government's role, especially the role of the MOSS talks, in these business transactions. Finally, I want to look into other possibilities for the U.S. government in this industry to make sure that the United States is doing all it should to assist our domestic auto parts industry, and, in turn, the U.S. worker.

These topics may sound familiar to those of you who follow the workings of this subcommittee. Last year, my colleague Sen. Quayle also invited witnesses to testify on the MOSS talks and on auto parts. His witnesses included representatives from the United States government, labor, the domestic auto parts industry, and an offshoot of a Japanese auto maker. I will not summarize those hearings in detail at this time. Let me merely state that those hearings laid a foundation for what we wish to accomplish today.

Those hearings established that a grave imbalance exists between the United States and Japan in the auto parts sector; the U.S. auto parts industry is competitive on the world's markets; a sourcing structure may exist between Japanese auto and parts makers which would have a tendency to exclude foreign participation; Japanese auto parts firms are increasingly deciding to locate in the United States for various reasons, not the least of which is to skirt "anti-Japanese" sentiment in the United States.

I would like to commend in particular the testimony at the September hearings of the United Auto Workers Union. Their analysis has supplied us with startling figures on the relationship between jobs created by an American auto plant and a foreign-owned auto plant in the United States. In this vital sector of the United States manufacturing economy, their leadership cannot be undervalued. I might add that only time constraints prevented me from inviting them again.

Sen. Quayle ended his hearing last September talking about competition. I quote: "We are manufacturing cars and spare parts at a much more efficient rate today than ever, and I would say that it is because of competition and nothing else, pure and simple. Competition is good for business, it is good for the consumer, and it is good for economic growth."

I could not agree more with my colleague's comments. I am still concerned, however, that what we have here is competition, but unfair competition. I must say that I am still unconvinced that the auto parts industry is operating under a system of fair competition.

As I have said at many a town meeting, I believe in free trade, but only if it is fair trade. The only way to achieve this fair trade is to examine our trade policy across the board. We in Congress must begin by creating workable and well-reasoned trade legislation to help us recover. For that reason, I was an original cosponsor of S. 490, the Senate omnibus trade bill. It strikes a good balance, being tough without being protectionist.

While in the legislative area, I would merely like to announce two of my witnesses in advance -- Congresswoman Marcy Kaptur and Congressman Sander Levin. Their leadership on this issue over the past years has brought the concerns of the auto parts industry into the national light. Auto parts plants tend to be located, for the most part, in the Great Lakes states -- Illinois, Indiana, Michigan, Ohio, but even as far south as Kentucky and Tennessee. I believe elected representatives from these states should be the ones to bring this problem to the attention of the nation.

But we must also realize that no single piece of legislation, no matter how well-crafted, will solve all of our trade difficulties. We must attack this problem on many levels and in many ways. Witnesses from the business community have told

Congress over and over that the federal budget deficit must be reduced in order to get our financial structure in line. Foreign debt, especially in Latin American countries, must be addressed. We must encourage businesses to expand beyond national borders to sell their products. We must make sure that the dollar stays at a level that makes U.S. goods price competitive on the world's markets. I believe that the nation is beginning to respond to this challenge.

I hope that these hearings today will not only give us an accurate assesment of the specific area of the auto parts problem and the steps taken to date to help correct it, but new ideas and new proposals to help the U.S. auto parts industry and its workers.

Since the September hearings, I have had the pleasure of receiving testimony from G. Glenn Gardner of Diamond-Star Motors in Normal, Illinois. I asked him to come testify concerning worker retraining, and in his testimony he made reference to the domestic content in DSM's products:

> These vehicles will be produced, not only with the 2,900 American workers employed by DSM, but with workers employed at the various U.S. companies supplying parts and components to DSM. As a matter of fact, DSM plans to utilize over 55 percent domestic content, and that level could expand further -- depending on market conditions and cost/quality considerations.

I commend Diamond Star Motors for this policy.

Before I introduce the first witness, Mr. Bruce Smart, I would like to state for the record that Mr. Makoto Kuroda, Vice Minister of MITI, Mr. Smart's counterpart at the MOSS talks, was also invited to share his thoughts with us today. Late last month I had a frank discussion with Mr. Kuroda about various trade issues, including the auto parts question. I wanted him to appear to make sure that the Japanese viewpoint was adequately represented. His schedule, unfortunately, precluded him from joining us. After the conclusion of these hearings I will be sending questions to Mr. Kuroda and will keep the record open so that his answers may be included among the responses from today's witnesses.

With that, I would like to introduce the Honorable Bruce Smart, Undersecretary of International Trade at the Department of Commerce. Mr. Smart.

EDWARD M KENNEDY CHAIRMAN

CLAIBORNE PELL RHODE ISLAND
HOWARD M METZENBAUM OHIO
SPARK M MATSUNAGA HAWAII
CHRISTOPHER J DODD CONNECTICUT
PAUL SIMON ILLINOIS
TOM HARKIN IOWA
BROCK ADAMS WASHINGTON
BARBARA A MIKULSKI MARYLAND

ORRIN G HATCH UTAH
ROBERT T STAFFORD VERMONT
DAN QUAYLE INDIANA
STROM THURMOND SOUTH CAROLINA
LOWELL P WEICKER JR CONNECTICUT
THAD COCHRAN MISSISSIPPI
GORDON J HUMPHREY NEW HAMPSHIRE

THOMAS M ROLLINS STAFF DIRECTOR AND CHIEF COUNSEL
HAYDEN G BRYAN MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, DC 20510-6300

THE MOSS TALKS AND THEIR EFFECT ON EMPLOYMENT IN THE U.S. AUTO PARTS INDUSTRY:

BACKGROUND FOR THE MARCH 30 HEARINGS BEFORE THE SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY, COMMITTEE ON LABOR AND HUMAN RESOURCES

Trade relations between the U.S. and Japan are perhaps more strained today than at any time in the last decade, a fact reflected in public opinion polls as well as in the U.S.-Japanese trade deficit of $58.6 billion for 1986.

Polls taken for the Japanese government and U.S. News and World Report in the last six months show the publics of both countries more distrustful of each other than they were just a few years ago.

With that sentiment as a backdrop, the U.S. and Japanese governments are considering three tough issues that will likely affect trade legislation in this Congress:

> SEMICONDUCTORS: A 1986 bilateral agreement that was supposed to end below-cost dumping of Japanese micro chips in the U.S. and third countries like Taiwan is on the verge of collapse. On behalf of the Reagan administration, Commerce Secretary Malcolm Baldridge has threatened to retaliate unless the Japanese government forces its manufacturers to toe the line. The attempted Japanese purchase of Fairchild Semiconductor, a U.S. company, exacerbated the situation. (The Senate recently voted without opposition to support retaliation against Japan.)
>
> KANSAI AIRPORT: Three of the world's worst airports, according to the International Civilian Aviation Organization, are in Japan. Seven of the best are in the U.S. Yet the Japanese have bluntly and very openly acted to prevent U.S. contractors, the world experts in airport construction, from bidding on the $6.5 billion Kansai airport now under construction at Osaka. Sen. Frank Murkowski has a bill he wants to attach to the Airport and Airways Improvement Act that would prevent Japanese contractors from getting

U.S. airport work unless American firms can have a share of Kansai.

AUTO PARTS: Next to the actual manufacture of autos, auto parts is one of the biggest industries in the U.S. and Japan. And since the Japanese auto industry is almost as large as the U.S. auto industry, auto parts trade with Japan is far more important than before. There are two components to this problem: the Japanese market is closed to U.S. auto parts firms, and the wave of Japanese auto makers relocating in the U.S. has brought behind it a tidal wave of parts firms, lured by state and local incentives, who not only count on business from the Japanese automakers, but covet work from American makers as well.

THE ISSUES

AN INTERNATIONAL AND DOMESTIC PROBLEM

The U.S. auto parts industry was in turmoil before 1980 because of the damage wreaked by the 1970s oil crises and recessions. Because the fortunes of auto parts makers were tied to the automakers, their sales dropped off during the 1970s, although not as much as the manufacturers.

Since then, the rising value of the dollar, the collapse of exports to Latin America, use of foreign parts by the "Big Three" U.S. automakers and the tremendous growth in Japanese auto firms locating in the U.S. have combined to hurt the industry even more.

In constant dollars, industry sales have shrunk by one-third since 1972. Sales peaked in 1978. They were $85 billion in 1985, the most recent year for which complete figures are available. Employment follows the same curve as sales: a high of 734,000 in 1978; down to 562,000 by 1983.

The Latin American debt crisis is directly responsible, as is the rising dollar, for curtailing the export business of U.S. auto parts makers.

As recently as 1981, the U.S. posted an auto parts trade surplus of $3.7 billion. Then a downward slide took hold. The deficit in auto parts trade ballooned to $5.86 billion in 1986.

Most U.S. export sales have been for variants of U.S. cars assembled south of the border in Mexico or Venezuela. (This analysis excludes Canada, which is a separate case altogether in the auto parts trade situation).

Several Latin American countries, faced with burgeoning debts, have slowed purchases of U.S. parts or implemented tough local content laws that force U.S. companies to build their auto parts in the country if they hope to sell there. These policies are meant to bring more hard currency to a debt-ridden nation rather than send it off to the U.S.

The rising dollar made U.S. auto parts all that more expensive and unattractive while the debt woes grew across Latin America.

General Motors, Chrysler and Ford have exacerbated the problem by putting out "Buy American" campaigns while quietly increasing their own purchases of Japanese auto parts exponentially.

For example, all three have offices in Tokyo, encourage joint ventures with Japanese firms and will sometimes help them relocate here.

Last year, GM and Ford each bought more than $300 million in auto parts from Japanese firms. Overall, more than $3.8 billion in Japanese parts went to the U.S. Japanese firms, in contrast, bought about $203 million in parts from ALL U.S. auto parts firms, less than 1% of the Japanese market for parts.

At the same time the prime export market for U.S. auto parts began to shrink and U.S. automakers began buying from the Japanese in increased quantities, Japanese automakers and auto parts firms began to settle in the U.S.

The Japanese automakers came here in part to escape their own Voluntary Restraint Agreements and to ameliorate protectionist pressure. With cars built in the U.S., Japanese nameplates could be sold until demand was satisfied, a point that was usually far above the VRA quota.

The Japanese automakers were flush with dollars too, thanks to their trade surplus with the U.S. For them, it made sense to pour dollars back into a dollar marketplace. Advantageous loans from growing money center banks in Japan helped them along. As the Japanese auto firms arrived, they were met by happy governors offering great tax, loan and land deals.

States have given several hundred million in incentives to Japanese auto firms in order to entice them to a particular locale. Many times, states compete against each other, bargaining away tax dollars or adding public improvement projects to sweeten a deal.

A second wave is now underway. The Japanese auto parts firms that used to serve the auto makers in Japan are taking advantage of the same great gubernatorial deals and low-cost bank financing to relocate here. Sometimes the parts firms are encouraged by the Japanese auto makers. There are rumors of ultimatums: "you will move to the U.S. or lose your business with us." Such relationships have been reported in Japan, along with government intervention to prevent auto makers from pressing small suppliers. As yet, no similar direct relationship has been proven in the relocation of Japanese auto parts firms here in the U.S.

The Commerce Department's own studies recognize the inherent intensity of the competition among Japanese auto parts firms seeking to relocate here. (See Tab 4 for Peters report to U.S. and Foreign Commercial Service).

The Japanese auto parts industry is tremendously competitive, with thousands of firms. Elaborate "family" relationships bind companies together: more than 200 suppliers are in the Toyota family network, more than 100 in the Nissan network. Many of these are "Mom and Pop" establishments dependent on the automakers for their earnings. Many are partially or wholly owned subsidiaries of the automakers. These relationships are preserved when the auto parts makers join the automakers in the U.S. Traditional U.S. parts makers claim that these relationships shut them out of the competition for work with the new Japanese plants. (See tab 7, Department of Commerce listing of relationships between automakers and suppliers).

More than 300 more Japanese parts firms may relocate here in the next two years, according to the Peters analysis. The problem is that the U.S. parts industry is already at overcapacity: for each new job created by a Japanese parts firm, the situation is almost cause and effect, with an existing job that could be lost.

The United Auto Workers union, which has studied this area, contends that the replacement jobs pay less and that there are fewer of them.

The union's September 12-19, 1986 Washington Report estimated that an American auto assembly plant producing 200,000 cars per year will create 25,000 jobs.

The UAW said a "transplant," or Japanese auto firm in the U.S., produces only 6,700 jobs. In some important "hard parts" areas, the union said a transplant creates no new jobs. Among those areas are manufacture of drivetrain, castings, carburetors and pistons, and tooling.

While estimates of the number of Japanese auto parts firms runs up to 8,000, the number of U.S. makers is about 2,000. The top one-third of U.S. firms account for two-thirds of the business, according to the Department of Commerce.

Japan has never been a big market for U.S. auto parts overseas. This is directly tied to how many U.S. cars are sold there. The high point was 19,000 cars in 1979. Last year, U.S. makers sold 2,700 cars in Japan. In comparison, Japan sold more than 1 million cars here in 1979; almost 2.6 million in 1986.

U.S. automakers have generally considered the Japanese market too small for major sales efforts. U.S. auto parts makers followed suit since they had traditionally made their goods for U.S. cars, either for the factory or to be sold "aftermarket" in stores including Kmart and Sears.

Until the number of U.S.-owned Japanese cars grew into the millions in the 1980s, U.S. auto parts makers had similarly put aside any thoughts of going after the "aftermarket" for Japanese cars imported to the U.S.

The use of Japanese parts by the Big Three, and the relocation of Japanese auto plants in the U.S. have changed the thinking of auto parts executives.

They want to sell in Japan, but recognize there are problems of language, custom and tradition. They are therefore more immediately interested in retaining sales in their own backyard.

That is why sales to the U.S. plants of Japanese automakers are crucial to U.S. auto parts firms. That is why the companies say they must fight the tax breaks, loans and incentives that are used to lure Japanese auto parts firms to the U.S. They argue that the same incentives are not offered to existing U.S. auto parts firms.

These issues are now being debated in several forums:

THE MOSS TALKS

MOSS stands for Market Oriented, Sector-Specific and is the appellation used to describe bilateral U.S.-Japanese trade talks in telecommunications, medical equipment, lumber, high technology and now, auto parts.

The auto parts talks resulted after urgings from Representatives Marcy Kaptur and Sander Levin (witnesses at the hearing) and members of industry associations.

The MOSS talks are to conclude in August, with April negotiations in Tokyo and August in Washington. The prospects are hopeful, according to negotiators; auto parts makers have been critical, claiming the negotiators are still at square one.

The U.S. auto parts makers believe the Japanese government cannot persuade Japanese auto companies to reveal the amount of their parts purchases from U.S. firms. The U.S. auto parts makers are also skeptical that the Japanese Automobile Manufacturers Association (JAMA) will be able to convince its members to agree on standards for a reporting system of such purchases, a development that was announced after the February round of talks.

FOREIGN DIRECT INVESTMENT

This term refers to majority ownership interest in a U.S. enterprise by a foreign national or firm. The term generally applies to Japanese auto parts firms operating in the U.S.

Though two agencies within the Department of Commerce report some information on foreign investment in the U.S., there is no agency monitoring the flow of foreign capital to determine if the investment is beneficial.

No agency is weighing the cost of state and local incentives against the income from new jobs created or net jobs lost. In fact, no government agency is studying whether or not such relationships exist between the incentives, new jobs created and jobs lost.

At the state and local level, there is no study of such issues. State officials interviewed recently indicated that it was not their job to consider whether a bidding war with another state is too costly or is not in the national interest. The goal, according to one official, is to win the Japanese plant for your state, and let the loser state worry about its own problems.

FOREIGN-TRADE ZONES

Foreign-trade zones (FTZs) have existed passage of the Foreign-Trade Zones Act of 1934, and were originally intended to stimulate international trade.

They were to accomplish this end by allowing foreign and domestic goods to enter a zone without payment of Customs duties or excise taxes. If a U.S.-produced good left an FTZ and was exported, no duties were to be paid.

For years, however, the number of FTZs grew slowly. Then 1980 amendments to U.S. Customs regulations waived duties on U.S.-sourced processing costs in FTZs. A corresponding boom of applications and approvals for FTZ began through the federal Foreign-Trade Zones Board in Washington.

Well over 130 such zones now exist in the U.S. and several are reserved for future use.

FTZs figure greatly in the debate over auto parts, and within the context of foreign buying of parts and foreign investment, are perhaps the most visible indicator of the challenge facing U.S. auto parts makers.

By importing auto parts to an FTZ and assembling them into a completed car before they leave the zone, an auto manufacturer ends up paying a smaller Customs duty than if the parts entered the U.S. unassembled.

According to statistics collected by the Census Bureau and reported by the Department of Commerce in its publication A Competitive Assessment of the U.S. Automotive Parts Industry (March 1985), the number of auto manufacturers assembling in FTZs grew from three in 1981 to 25 by the end of 1984.

The value of imported auto parts entering these zones increased from $250 million in 1981 to $760 million in just two years.

The greatest share of these parts come from Japan. In 1983, $285 million worth of Japanese auto parts came into FTZs and were subject, thus, to reduced duties when they left as part of an assembled car.

That was a five-fold increase in value from 1982.

All major automakers in the U.S. use FTZs: AMC, Chrysler, Ford, General Motors, honda, Nissan and Volkswagen. Toyota is now seeking an FTZ subzone for its plant in Scott County, Kentucky, but is facing opposition from the Auto Parts and Accessories Association, which has filed a petition with the trade zones board in Washington that claims the FTZ will unfairly subsidize foreign parts makers in their competition for business with U.S. firms.

WHAT LIES AHEAD

The future relationship between U.S. parts makers and the Japanese automakers and auto parts firms is not certain, but studies prepared for the Department of Commerce depict a future that is far from rosy.

If action is not taken to open up overseas markets for U.S. firms and to retain and expand sales in the U.S., the Peters study argues that 300,000 jobs could be lost. The UAW believes the total could be higher, perhaps as much as 500,000.

Though the MOSS talks on auto parts have taken negotiators to Tokyo and Washington twice, they have as yet failed to produce agreement on a method of collecting the data that would be needed before any real analysis and corrective action could be negotiated for U.S.-Japanese trade in auto parts.

With the end of the MOSS round just four months away, and the possibility of a 50% decrease in auto parts employment in the future, Congress may well find that legislation is necessary to provide the leadership and guidance that can preserve and enhance a basic American industry.

Senator Simon. I will call on our first witness, Mr. Bruce Smart, whose official title is Under Secretary of International Trade with the U.S. Department of Commerce.

Mr. Smart, before I call on you, my colleague Senator Quayle, who held hearings on this issue last September, is here, and let me call on Senator Quayle.

Senator Quayle. Thank you very much, Mr. Chairman.

Mr. Secretary, I am glad to see you again.

I first of all want to thank you for continuing these hearings. They are not only important to the country, but they provide understanding of issues facing an industry that is exceedingly important to both of our States. We are very, very dependent upon the whole auto sector, particularly the auto parts aspect.

I want to make a special welcome to a couple of witnesses that you are going to have today, Mr. Chairman, Mr. Bruce Bowden and Mr. Bill Thornton, of the Stant Company in Connersville.

As I said, these hearings address an important problem and particularly the impact on employment, which is quite revealing. In the State of Indiana, we have over 40,000—think of that—over 40,000 jobs in the auto industry. We have over 250 companies in our State that manufacture auto parts.

So I congratulate you for continuing these hearings. I think that they are very, very important. There are a couple of areas I personally intend to concentrate on. One, I think it is important that we look at the composition of parts purchases by the Japanese. A lot of times you hear announcements that they are going to make "x" amount of dollars of purchases of these auto parts. The question is: what auto parts are they going to purchase? Are we going to purchases of the highly-engineered auto parts? What is the make-up of this? I think this is a very, very important aspect.

I also think that we have to look at the whole structure of the Japanese procurement practices—where the decisions are made, by whom, on what basis—the whole "keiretsu" issue should be revisited.

I thank you, Mr. Secretary, and your Department for working with us on our auto parts conference that we are going to have in Indianapolis on May 27th and 28th.

And also, Mr. Chairman, I am working and looking at legislation that will establish on a more permanent basis an ongoing system to better promote industry-to-industry contact, to continue that. I think such contact has been, and is very, very constructive thus far; I think it will be very, very helpful—not only to have better industry-to-industry contact, but to have a dispute settlement and resolution process in place once we get the facts before us. In addition, I am interested in what kind of mechanism we can establish in the all-important and sometimes elusive area of monitoring—how can we in fact monitor sales?

So those will be some of the aspects I will be looking at. And I certainly congratulate the Chairman for having these hearings and look forward to hearing what Secretary Smart and the other witnesses have to say.

Thank you very much.

I would ask unanimous consent that my entire statement be made a part of the record.

Senator SIMON. It will be entered in the record, and I might say for the benefit of all witnesses, we will put your full statements in the record, and we would like to ask you make a roughly five-minute summary of those statements. This little light machine will work; when it is yellow, that means one minute left, and when it is red, you know what it means. And then we would like to devote some time to questions and answers rather than to the lengthy statements.

[The prepared statement of Senator Quayle follows:]

Statement of U.S. Senator Dan Quayle (R-IN)
At the Employment and Productivity Subcommittee Hearing
On the MOSS Talks and Their Effect on U.S. Employment
in the Auto-Parts Industry
March 30, 1987

Mr. Chairman, thank you for the opportunity to share my views with the Subcommittee once again on the important issue of auto-parts trade with the Japanese, the ongoing Market-Oriented, Sector Specific (MOSS) Talks and their effect on U.S. employment.

I appreciate your interest in this topic. As you know, I held a hearing on this subject before this Subcommittee last fall in which you participated, Mr. Chairman, and I commend you for maintaining an interest in this topic, which is so important to both of our States.

I would like to extend a special welcome to Mr. Bruce Bowden and Mr. Bill Thornton of the Stant Corporation of Connersville, Indiana. Indiana is the home for over 115 auto-parts manufacturers, and this industry employs more than 31,000 in Indiana alone.

The obvious trade imbalance in auto parts that exists between the U.S. and Japan is a serious one, and one that must be seriously addressed. In 1986, the U.S. ran a deficit of $33 billion in auto-related trade with Japan, and nearly a $3.6 billion deficit in auto parts alone. Regardless of excuses and denials, these numbers speak for themselves: U.S. auto-parts manufacturers are being denied the opportunity to compete in the Japanese market, and this must change.

Recently, we have seen evidence that Japanese automakers with U.S.-based assembly plants are increasing their purchases of American-made parts. These purchases, whether motivated by favorable exchange rates or otherwise, should be applauded; they represent new opportunities for U.S. suppliers. But I would caution that we must reserve judgment on the success or failure of our efforts to increase fair and equitable treatment of American parts until history records a lasting and qualitative improvement in sales to Japanese auto manufacturers in Japan and here in the U.S.

Whether in the MOSS Talks, or through action by Congress, we need to establish a system for monitoring both the composition of parts purchases by the Japanese and the degree of change in the structure of Japanese auto company procurement practices.

As sales of American-made parts to Japanese automakers with plants in the U.S. increase, and they must, some will begin to argue that no bias against U.S. parts suppliers exists. They will point to the rising percentage of "domestic content" used in the assembly of Japanese cars made in America and consider the issue resolved.

To the contrary, I insist that a better gauge of the domestic parts industry's access to the Japanese original-equipment and secondary-parts market is the extent to which Japanese companies located here in the U.S. and in Japan are willing to purchase highly engineered and sophisticated components, along with interior items, plastics, upholstery and other so-called "soft" or "bulk" items. Of course, purchases of these bulk parts are also important, but they represent a smaller percent of the total value of the final product than do drive-train, electronic and computer components.

Recent announcements by Japanese automakers here of their contracts with American parts manufacturers appear to represent no real change in the Japanese practice of purchasing drive-train components from their traditional Japanese suppliers and importing them into the U.S. for assembly.

(MORE)

In my opinion, only when we see Japanese automakers here making increased and sustained purchases of quality, price-competitive parts in these high-value categories can we maintain that a legitimate improvement has occurred in the commercial relationship between U.S. parts suppliers and the Japanese auto industry.

The mechanism by which Japanese auto companies decide whether to purchase parts from American sources is the second area that requires close scrutiny.

There has been much talk about the "keiritsu" relationship that exists between Japanese auto companies and their traditional family of suppliers. Unless this preferential relationship is altered in order to provide U.S. parts makers equal access to markets in Japan, or should it be maintained in the U.S. market, American parts suppliers' ability to compete for sales will remain handicapped by a factor that goes far beyond considerations of quality, dependability and price.

For there to be lasting improvement in U.S. auto-parts sales to the Japanese automakers, their procurement process must be made open to American companies. Traditional suppliers of parts to Japanese auto companies are integrally involved in the design and development of new car models. U.S. parts manufacturers must be given access to this critical process too, and they must be judged on the same basis as their Japanese competitors.

So what should we do to improve sales and combat this bias against U.S.-made parts?

Our negotiatiors at the MOSS Talks have made several suggestions that deserve attention and support. One important U.S. objective is the development of a system for the monitoring of purchases of American-made parts by the Japanese. In order to measure any improvement in sales accurately, we must have a credible system of accounting. I support this initiative as long as the U.S. and Japanese governments supervise its implementation, and I have stressed this point in a recent meeting in my office with Japanese Vice Minister of Trade Makato Kuroda. While I have been disappointed with the progress of negotiations on this point to date, I hope that the Japanese will cooperate in the development of a responsible and reliable system of monitoring.

The monitoring of sales is essential after the fact, but on a more fundamental level, I believe the key to stimulating increased commerce between U.S. suppliers and Japanese automakers is accelerated industry-to-industry contact and education. The MOSS Talks have already led to increased communication, new business opportunities and a better mutual understanding of the situation facing U.S. parts companies seeking access to the Japanese market. Further steps in this direction are planned.

First, I am pleased to note that on May 27 and 28, the U.S. Department of Commerce, U.S. Senator Richard Lugar (R-IN) and I will sponsor a Conference on Selling Auto Parts to the Japanese. This national conference, which will be held in Indianapolis, Indiana, is being organized in cooperation with the Japanese Ministry of International Trade and Industry and the Japanese Auto Manufacturers Association.

In addition, I intend to introduce legislation in the near future that requires the Secretary of Commerce and the U.S. Trade Representative to establish a process for ongoing industry-to-industry contact, dispute settlement and monitoring of sales. This legislation will also call on the Commerce Secretary to pursue follow-up negotiations between the two governments periodically after the conclusion of the MOSS talks.

Both the upcoming Conference on Selling Auto Parts to the Japanese and my legislation reflect my view that real progress in U.S.-Japan auto-parts trade requires increased contact between industry officials under the sustained supervision of both governments. This attention and exchange of information will provide the opportunity for increased commerce in a positive approach that reflects our seriousness in addressing this issue, while also being sensitive to the friendship and importance of our relationship with Japan.

Senator SIMON. Secretary Smart, we are pleased to have you here.

STATEMENT OF HON. BRUCE SMART, UNDER SECRETARY OF INTERNATIONAL TRADE, U.S. DEPARTMENT OF COMMERCE

Mr. SMART. Thank you, Mr. Chairman.

I am glad to have a chance to testify, sir, on this very important subject. I have submitted written testimony for the record and will try to give a little background that perhaps can be helpful in stimulating discussion on some aspects of it, but not all.

We are going to try to present the problems of the auto parts trade, what we hope to do about it, and where we are in the MOSS talks that are now in progress. I will not in these remarks cover either the investment issue or the Foreign Trade Zone issue, although those are both relevant to the situation and are touched on in my written testimony.

As you pointed out, Mr. Chairman, the merchandise trade deficit with Japan was somewhat over $58 billion in 1986, and of that, the automotive segment, both finished cars and parts, was by far the largest, representing about 56 percent of the total. Parts actually is about $6 billion of deficit if you include not only the parts that come in as parts, but the parts that come into Foreign Trade Zones and then are counted in our recordkeeping as finished cars. So that it is a very important part, about 10 percent of our total trade deficit with Japan.

Exports to Japan have been stuck at about $200 million for the last three years, while imports have been growing very rapidly and were $6.2 billion in 1986. That means that we sell to the Japanese about $26 of parts for every car that they make; and for every car that is made in the United States we buy about $700 worth of Japanese parts and components. That is a tremendous difference.

And the problem we are addressing is why is that the case and how can we correct it.

The problem is in very small measure Japanese government policies and in very large measure the private practices of purchasing departments and Japanese auto company managements who have gone for many years with a family of tightly-knit companies that supply them and on whom they rely. It is very hard for outsiders to crack that so-called family or "keiretsu" circle, even if they are a Japanese company let alone a foreign company such as an American company.

We started out being interested in this in the Department of Commerce as an export promotion effort, and for some months we worked trying to help American companies to crack that circle in Japan, because we believed that if you could be accepted as an original equipment supplier in Japan, you would then have a better chance to sell to the new Japanese assembly plants in the United States, and you would also be certified as an appropriate supplier of aftermarket parts for repairs and maintenance.

That was going along rather slowly, and so we decided to try to elevate it by giving it MOSS status, which means that the Japanese government accepts the fact that this is an important area and lends its weight to correcting the situation.

In the case of the four previous MOSS sectors, we were attacking Japanese government practices that were impeding access of American firms to the Japanese market. And this is somewhat different because it is attacking private practices.

For this reason, it is a much more difficult sector, but one that we have made, we think, at least some progress on in the last six months.

We are obviously trying to open up both the original equipment market and the aftermarket. We are trying to do it in Japan, we are trying to do it in the United States, and we are trying to do it in third countries.

We have had four sets of talks so far. What have we achieved? First of all, and I think perhaps the biggest achievement, is that we have heightened the awareness among Japanese auto companies that their acceptability in the U.S. market as important brand names is threatened if they get the feeling that somehow they are unresponsive to U.S. concerns. And every time you meet a representative from one of those companies, he is quick to point out what they are doing to make it possible for American suppliers to have a bigger share of the market.

We have concluded a number of case-by-case analyses, looking at Japanese complaints of American noncompetitiveness and at U.S. complaints of lack of access. And in some cases, those cases have been resolved to the benefit of the customer-supplier relationship.

We are cooperating through our Trade Development Unit in seminars and sales promotion both in the United States and in Japan, of which Senator Quayle's meeting in Indianapolis is one example.

We have caused the Japanese firms to establish individual contact points in their purchasing departments so that our people will know where to go. We are supporting the opening of an office in Japan for American firms to promote auto parts sales there. We have reached general agreement that data is necessary if we are to measure how we are doing. And the Japanese government has agreed to advise inspectors and consumers that using American parts will not prevent them from passing the safety inspections.

Our next meeting in April is the 21st and 22nd in Tokyo. We will conclude our talks by the end of August. We hope in the next meeting to get a better handle on the database that we need and on how to report against it, a baseline set of figures, categories into which parts should be divided, frequency of reporting, and some indication of leading indicator reports on new relationships being established.

But ultimately, the answer to this is to get more sales in each of the markets we are dealing with, and that will be the test of our success.

[The prepared statement of Mr. Smart follows:]

TESTIMONY BEFORE THE
SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY

ON

U.S.-JAPAN RELATIONS IN THE AUTO PARTS INDUSTRY

BRUCE SMART
UNDER SECRETARY OF COMMERCE
FOR INTERNATIONAL TRADE

MARCH 30, 1987

Thank you Mr. Chairman, and Members of the Committee, for this opportunity to update you on U.S.-Japan relations in the auto parts sector.

In 1986, we had a deficit of $33 billion in the automotive sector (vehicles and parts) with Japan--more than half of our total trade deficit with them. Obviously, it is critical for us to obtain fair trading conditions.

When I spoke before this Committee in September, the Transportation Machinery MOSS (market-oriented, sector-selective) talks on auto parts had just started. I said then that the task ahead would not be easy. It hasn't been. While we have made some progress, we face difficult problems. There are no simple solutions.

These talks are different from most trade negotiations. The primary barriers to sales are Japanese corporate business practices, not government policies or intervention. These practices exist in the Japanese and U.S. markets. We asked the Japanese for MOSS status however, because we believe their government should be concerned and involved.

The U.S. trade deficit with Japan in auto parts totaled $3.6 billion in 1986. In addition, Japanese auto parts manufacturers, located in the United States, grew from 10 plants in 1980 to over 110 on-line or announced plants as of March 1987. This number is expected to grow. This rapid increase in investment has created concern among U.S. producers that they do not, and will not, have the same access as their Japanese competitors to the new Japanese vehicle assembly plants located in the United States.

Status of the Talks

The MOSS mid-term interim report outlines progress to date. This report was released by our governments after the fourth round of talks in February.

The U.S. objective in these talks is to ensure that U.S. automotive parts firms can sell to Japanese vehicle makers without being kept out by nonmarket factors. We also want to eliminate any remaining government regulations or other barriers which prevent access by U.S. parts manufacturers. In addition, we want full access worldwide to the maintenance and repair parts market for Japanese-brand vehicles.

U.S. companies have been denied equal access primarily by the close, traditional relationships between Japanese vehicle manufacturers and their suppliers. These relationships have made it extremely difficult for new companies to break into the supplier network. This relationship is a barrier in Japan and threatens to be transplanted to the United States.

We believe the Japanese supplier system discriminates against foreign suppliers. Our objective is not to tear down the Japanese purchasing system but to force it to change. By allowing the entrance of competitive foreign auto parts companies, we will benefit and so will the Japanese economy.

The Government of Japan claims no barriers exist. They assert that U.S. auto parts companies are not competitive and do not understand the concepts of quality, just-in-time delivery and joint design development.

The Japanese Government does recognize, however, the need to lower trade tension. Thus, they have agreed to expand opportunities for U.S. and other foreign suppliers. We will help them.

We have made some progress, but many details remain to be resolved by the agreed deadline of August.

Data collection has been a major point of contention. In February, we achieved general agreement on the need to have data, both to know where we are and to measure progress against our starting point.

The Japan Automobile Manufacturers Association will collect critical data, with the "encouragement" of the Japanese Ministry of International Trade and Industry, covering Japan Fiscal Years 1985 and 1986, and semiannual data thereafter. The data will: (1) cover purchases of parts for use in the Japanese market and in the U.S. market; (2) represent a reasonable number of categories of parts; (3) include categories of all parts, accessories and materials used in the production of motor vehicles; and (4) be expressed in dollar terms with the relevant exchange rate specified.

In the next round of talks, we will discuss: (1) the duration of the data collection system; (2) a precise definition of the categories to be used; and (3) a precise definition of U.S. auto parts.

Since short-term sales data will not adequately reflect progress in building long-term relationships, the data collection system must continue for a substantial period, in our opinion for a minimum of five years. It will also be useful to develop some method of capturing as a "leading indicator" the creation of the long-term relationships as early as possible.

We will also discuss the breakdown into categories. We need enough categories to adequately judge if improved market access has taken place, where it is taking place, or not taking place, and why. We are currently working with the U.S. industry to determine what would constitute a useful, but manageable, number of categories.

The U.S. Government has proposed that each Japanese vehicle company specify a contact in its engineering department to help U.S. suppliers arrange appointments with Japanese engineers. Such access is important for suppliers who want to participate in long-term development and new model design.

In response, the Japanese have submitted a list of purchasing department contacts for original equipment parts, replacement parts and accessories at each Japanese motor vehicle manufacturer and its U.S. subsidiaries. The Japanese have assured us that these purchasing department contacts will make the necessary introductions to the engineering departments. If the list is ineffective, we will seek further assistance from the Government of Japan. We have distributed it to U.S. companies urging them to use it and let us know its effectiveness.

Some Japanese consumers and repair shops now believe that the use of foreign parts will prevent their cars from passing required safety inspections. The Japanese Government has agreed to a public awareness campaign to tell safety inspectors and operators that the use of foreign parts will not be an obstacle to passing the safety inspection. We will work closely with the Japanese Ministry of Transport to ensure that this campaign is adequately implemented so that U.S. suppliers have full access to the Japanese auto parts aftermarket.

The Japanese Government also agreed to continue its cooperation in trade development. Official efforts are needed to expand U.S. sales. At our urging, the Japanese Government has agreed to work with the Japan Automobile Manufacturers Association on a major conference on selling auto parts to Japanese vehicle manufacturers. Sponsored by the Commerce Department and Senators Quayle and Lugar, the conference will be held in Indianapolis on May 27 and 28. In addition, the Japanese Government will assist U.S. participation in the 1987 Tokyo Motor Show.

The Government of Japan has strongly supported the U.S. auto parts industry's office in Tokyo, Japan, scheduled to open this Spring. This office is funded by our Department and the Motor and Equipment Manufacturers' Association.

The MOSS mid-term report refers to cases in which U.S. companies felt they were being unfairly excluded, or Japanese companies felt U.S. companies were inadequate. We found that some cases were due to misunderstandings of intentions or procedures. In some cases, the Japanese company had not given the U.S. supplier a fair chance; and, in other cases, the U.S. supplier had not fulfilled quality or other expectations. Some negotiations have resumed after both sides made sincere efforts to work together. We will continue these discussions to deepen understanding of problems and to foster better purchaser-supplier relationships.

The next round of talks is scheduled in Tokyo April 21 and 22. It will focus on the data collection system and the Ministry of Transport's public awareness campaign.

Japanese Auto Parts Investment in the United States

Many U.S. auto parts companies are concerned over the construction of manufacturing plants in the United States by Japanese suppliers. They point out that these suppliers start with their traditional ties and long-term committments from the assembly plant, a situation which can lock out U.S. suppliers. Secondly, they will provide increased competition for the business of U.S. auto manufacturers. These Japanese parts companies are more likely to source offshore than their American competitors, and their proliferation can lead to fewer U.S. auto parts jobs.

There are several reasons for the expansion of Japanese direct investment in the U.S. auto parts sector. The Japanese auto parts companies expect their Government's restrictions on auto exports to the United States to continue. Therefore, any additional Japanese-brand vehicles in the U.S. market will be produced in U.S. assembly operations. Japanese auto parts companies want to grow by supplying these assembly operations. To remain competitive and serve the assemblers' just-in-time requirements, manufacturing operations in the United States are desirable. Like their customer plants, they provide a hedge against a higher valued yen.

The U.S. motor vehicle market is the largest in the world and the fastest growing market for parts for Japanese vehicles. Demand in Japan is relatively flat.

These factors offer incentives for Japanese parts manufacturers to establish a presence here.

The Administration has no objections to direct Japanese investment. But U.S. auto parts companies must not be excluded unfairly from the competition.

Judging Success

Both governments have agreed to finish the talks by this August. By then, we will have to evaluate what we have accomplished.

The Government of Japan has resisted using conomic criteria to evaluate progress. We have insisted on doing so. In February, the

Japanese agreed success will be judged by significant increases in annual sales by U.S. auto parts companies to Japanese vehicle companies, and by the initiation of long term sourcing relationships. We will also look for a positive assessment from a significant number of U.S. parts companies that access to the Japanese market and vehicle companies has improved.

Again, the task ahead is not easy. I am hopeful that by working together--the industry, the Congress and the Administration--we can make progress. Thank you.

Senator SIMON. Thank you, Mr. Secretary—well-timed.

Skeptics might say you have concluded some meetings, you are going to be having another meeting in April, another meeting in August, and there does not seem to be a sense of urgency. We are going to have a lot of auto parts companies in this country go belly-up in the meantime, while we wait for April and August to come around.

How would you respond to that?

Mr. SMART. Well, I would respond that the MOSS process is by its nature a developmental process and a process that goes forward in steps. Traditionally a year has been established as the proper time to get at something as complicated as this.

We have had four meetings. We have another in April. We probably will have one between then and the final wrap-up meeting in August—possibly two. That is a lot of meetings for the Japanese and the U.S. Government to have and have staff time in between to study and make progress on what has eventuated in the meetings.

So I would say we are working at it about as fast as we can, particularly recognizing that we are dealing with private business decisions and not with Government barriers.

Senator SIMON. If things move along as you anticipate right now, two years from now—you mentioned the $26 figure and the $700 figure, or $26 U.S. parts in Japanese cars, and $700 of Japanese parts in a U.S. car—where will we be two years from now?

Mr. SMART. That is very hard to say, Senator. Obviously, I hope we will be selling a lot more than $26 per car in Japan, and hopefully, while we want to keep our market open to suppliers of any nation, we will not see that $700 figure greatly increase. I would love to see American companies regain some of that ground, but it is almost impossible to predict how much.

Our concern is access to markets on a fair and equal basis, not a predisposition as to who gets how much.

Senator SIMON. I understand that. But if in fact you have that free access to markets, there ought to be a substantial shift. I am not going to say it is going to be a 50-50 kind of exchange. Do you anticipate there will be that access; are we going to have a substantial shift?

Mr. SMART. My guess is yes, because I think it has to be in the interests of the Japanese nation and in the interests of their auto companies to engage in freer and more open trade than they have in the past.

But "keiretsu" which in a way is another big extension of buying insurance from your brother-in-law is something that takes a while to overcome.

I began my business career as a salesman, and I tried to establish "keiretsu" with customers, and it was successful on some occasions. But as professional purchasing methods moved in, that has been replaced by a rather impartial, nonemotional value of who can bring the best supply to your company, all things considered, and I would see that as being in the Japanese interest if they are going to remain as large as they are in the world auto market.

So I think yes, we will have greater opportunities with them, but I cannot predict how fast.

Senator SIMON. And in that connection with greater opportunities, I note that there is a public relations program being launched by our friends in Japan, a very large ad in the Japan Times and other ads apparently going to be coming. That is fine. As a former newspaper publisher, I like to see those ads in the newspapers. But that is not a substitute for real change.

And I think what Senator Quayle and I and our colleagues and Congresswoman Kaptur and Congressman Levin really are looking for is substantial change. And if that does not occur, then the legislative vehicle may be used. And sometimes that is used wisely, and sometimes it is not used wisely.

Senator Quayle?

Senator QUAYLE. Thank you very much, Mr. Chairman. I would certainly agree that we are looking for either change or progress or some amelioration of the problem that exists.

I wonder, Mr. Secretary, if you might just give us from your viewpoint how this weekend's decision on retaliation against Japan in the semiconductors will affect the MOSS talks. It seems to me that in this particular case where there was a breach of contract or understanding that we had with Japan and I might add that we are not to that point yet on the MOSS talks, that a fairly strong message was sent that—any administration, whether it is this administration or any other administration, while reluctant to impose any kind of penalties against a trading partner and against an ally—but that in this case, where it was simply so apparent that they will act.

And I just wonder how you feel this weekend's decision might impact the MOSS talks and the discussions that you are going to have with Japan. I would think, and I would certainly hope, that they got the message in no uncertain terms and that this might be the first shot across the bow that we are deadly serious about this trade deficit and the trade problem that we have, whether it is the auto parts where we have about a $4 billion bilateral deficit or the overall trade deficit, where we have about a $50 billion deficit.

Mr. SMART. Well, Senator, as you point out, it certainly is an indication that the U.S. patience has come to an end. In the case of semiconductors, we initialed an agreement on the night of July 30th, we signed it on September 2nd. We had several meetings during the fall, urging the Japanese to move more rapidly in both market access and in the stopping of dumping in third country markets. We called for consultations and had them in late January, at which point we set deadlines of time. And it is amazing to me that the Japanese are surprised that now, after that eight-month period, we suddenly have decided to take action.

I hope it will persuade them that we are serious about this business of market access and fair trade. If it does, it clearly will have an effect on auto parts, despite the fact that as you point out, the semiconductor situation was an agreement between two governments, and this is an investigation of private business practices. It has to be of concern to them; this is more than half of their sales in the United States is in the automotive sector, and they need and live on exports. This is a very important area for them, and it is a very important area for us, too, because we want our consumers to have the opportunity to buy fairly-traded Japanese goods.

Senator **Quayle**. Well, I would certainly hope so, and I as one would just reiterate that we are not only interested, but serious, and if we do not get results, if we do not receive progress, then there will be other responses.

I wonder, Mr. Secretary, if you could tell me if the Japanese have in fact acknowledged and concede that there is a bias against outside sources in the auto parts particularly coming into their country. Do they acknowledge that this is a problem, or do they say it is really not a problem? Do they acknowledge that they have some cultural differences, that they have certain business practices that may deny U.S. suppliers access to other markets?

In other words, before we solve the problem, we have got to recognize that there is a problem, and I just wonder from your viewpoint if they have in fact acknowledged that there is this problem.

Mr. **Smart**. I think it is hard to generalize. There are 120-plus million Japanese, and I am sure they do not all have the same opinions. But generally speaking, what you hear is that the United States companies do not understand just-in-time delivery, do not match the quality of product that their Japanese competitors have attained, and are unable to provide innovations early on in the design and development process which would qualify them for supplying equipment on new models.

Those things are, in my opinion, and we tried to persuade them, untrue. Many American industries are highly competitive in this, both in the automotive industry and other places. There is no secret to just-in-time inventory as a way to remove costs from the system. And all we ask is a chance, and that is where our case histories have been somewhat helpful in demonstrating what we can do.

The Japanese concede that there are some American parts suppliers who are good, but they consider them to be sort of an exception to the general rule. So we have a job to do of at least persuading them, if indeed what they say is what they think, that we can do better than our reputation with them seems to be. That is part of our job, is to get an opportunity to demonstrate that we are good and then go from there.

As yet, I would say significant numbers of them are not fully persuaded—incorrectly, I am sure.

Senator **Quayle**. Significant numbers do not recognize that there is this problem.

Mr. **Smart**. That is correct.

Senator **Quayle**. Well, I think that that makes our task even more difficult if there is not a recognition of this problem.

Mr. **Smart**. Yes, it does.

Senator **Quayle**. How does that square with the comment that was made a few days ago, I think by Mr. Kuroda, concerning microchips. He allegedly stated that he did not care whether U.S. products cost less or were of better quality; they were not going to buy them anyway! Is that something they said? Is that a policy of the Japanese government? And if so, is this indicative of the type of problem that we have?

Mr. **Smart**. Mr. Kuroda is a very capable and patriotic and outspoken representative of his government, and sometimes he is given to hyperbole. But he is a tough negotiator.

Senator QUAYLE. What would you call that statement?

Mr. SMART. I think that is somewhere between he believes it and hyperbole.

Senator QUAYLE. It is probably true that he believes it, and this may be part of the problem we face. I thought it was quite revealing.

Mr. SMART. He has been quoted on a couple of occasions as saying that the Americans do not make anything the Japanese want to buy. I think that is an overstatement since the Japanese, while they are not great importers in the world, import something like 40 percent of their goods from the United States. We are their biggest supplier.

Senator QUAYLE. Well, whether it is hyperbole or reality, I can tell you that when you get statements like that from Japanese government officials, it does not send very good messages over here. I can tell you that when I heard of this, I was horrified. I could understand what he was saying, but if in fact he really believes that—and I think that perhaps he does believe that, I think it shows that perhaps all of these discussions we have been having are for naught. I mean, if a person down deep says, "It does not make any difference, Mr. Chairman, whether it is high-quality and lower cost, we are not going to buy them anyway." Secretary Smart and others have expended a lot of talent and energy for something that is going to be very, very difficult to achieve.

And as one who has met with him and certainly found him engaging even though we have vast differences, I was really quite taken by that comment.

One other, final——

Senator SIMON. Would my colleague yield?

Senator QUAYLE. Yes, I would be glad to yield.

Senator SIMON. I think it is an indication of why there is some bristling on the part of Members of Congress. The Washington Post of March 26 quotes Mr. Kuroda as saying that he told the Americans over lunch that it was a waste of time for the United States to try to sell supercomputers to Japanese government agencies or universities, no matter how superior they were in price or quality. Those are the kinds of things that cause problems, and there have just been too many.

Senator QUAYLE. I think you know what we are saying, and we are trying to be as polite as possible, but sometimes it is difficult. We will be restrained today, but I think this is just indicative of our attitude on this issue.

That is why, as I have said to you and others, we have expended an inordinate amount of resources and time and energy to sit down and try to talk out these problems. And yet you get a comment like that, which means it does not make any difference. It is a facade. It is a joke. They are not going to change. I mean, if they have got that basic premonition and that basic feeling, no matter how successful and skilled you are as a negotiator, the results are going to be very, very marginal, and I think that is a very unfortunate situation.

One final area of questioning. I would like to get your comment on how we might establish a continuation of some very positive things that I think have come out of your talks. One, the industry-to-industry contact. You mentioned our Indianapolis auto parts as an example. Two, how can we establish a system of monitoring on a permanent basis. And three, a resolution of these disputes.

Those are three criteria that, as I said, I am contemplating, and I am now looking at a legislative initiative on those particular aspects, and I just would like for you to comment. Do you think I am on the right road? Do you think it would be helpful to you, or to our industry and to our two countries to pursue a vehicle that would include these elements.

Mr. SMART. Well, obviously, anything that we can do to get the buyer and seller closer together and understanding each others' problems will be helpful. And it may well be that individual Japanese companies ultimately have as much or more to gain from buying from American companies as the Japanese government goes.

So I think the kind of seminars that we have been having around the country—and yours is sort of a blue ribbon kind of seminar—between buyer and seller companies are very useful. I think promotional efforts such as we are sponsoring in Japan can be very helpful. I think the office that we are establishing there, manned by the trade associations to help American companies who are not large enough to have their own activities in Japan, understand that market, and sell into it, can be very helpful; and ultimately, then, the case-by-case resolution is a system that perhaps that office or other capabilities in coordination with our Department can continue to do.

But as you say, it is going to take a lot of resources to push this thing forward, and if we have to deal with all of these conditions, not just auto parts but wherever we have these problems, on a case-by-case retail basis, it is going to be difficult. So we need to find a change, I think, perhaps of heart in the Japanese government to where it says yes, American suppliers can be good, and when they are, we will treat them without regard to the fact that they are competing with Japanese national companies.

Senator QUAYLE. Would legislation furthering these ideas along be helpful, in your opinion?

Mr. SMART. I would like to think about that.

Senator QUAYLE. Okay. Fair enough.

Mr. SMART. I am not prepared to say that it would or for that matter that it would not, but let me think about it.

Senator QUAYLE. Let me just make this pledge to you and also to the Chairman. I will be glad as we get further down the road to share these thoughts and ideas with you. I think it is important, Mr. Chairman, that somehow, once the MOSS talks discontinue and are ended, that we have some sort of formal mechanism where we can continue this dialogue and communication. And therefore, I throw out possible legislation that may or may not be necessary, and I look forward to working with you as we sort of flesh these issues out.

Mr. SMART. One of our objectives in the database is to continue monitoring for a period of at least five years so that we will have an ongoing measurement of how we are doing. Also, the Chairman brought up the subject of Foreign Trade Zones, and we are making a study of how effective those have been, what their good aspects have been, and what the negatives of them have been, and it is conceivable that that will lend itself to some sort of legislative action, but we have not completed that.

Senator QUAYLE. When will that report be forthcoming?

Mr. SMART. Well, we have just started to make it. We have not put a time limit on it, but it is going to take two or three months at least.

Senator QUAYLE. Thank you very much, Mr. Chairman.

Senator SIMON. Thank you.

Just another couple of questions—and I might mention also, for Japanese reporters who may be here, and I assume one or two of those television cameras may be from Japan, if this trade deficit were in reverse, Japan would be very much concerned about that trade deficit. And I would understand that. It is unhealthy to have that big a gap between any two countries. And ultimately, it is not in the best interest of Japan to have a U.S. economy that is faltering. And if this kind of a trade pattern continues, we will have a substantially faltering economy.

The Foreign Trade Zone question, you just answered.

Two other questions very briefly, Mr. Smart. To what extent do we have adequate coordination now on trade issues? In other words, on an issue like this, do you work with Clayton Yeutter, do you work with the State Department? How do we coordinate to make sure that we have an effective policy, and who makes the final decision as to where we are going?

Mr. SMART. The trade negotiations with Japan on auto parts were started with the Department of Commerce under our responsibility as the lead agency for export promotion. When we decided that they should be moved into the MOSS process to get the imprimatur of the Japanese government more firmly on top of them, that process is managed by the State Department under Under Secretary Allan Wallace; and he agreed that they should be part of the MOSS, negotiated with the Japanese Foreign Ministry to have them part of the MOSS, and then assigned us to continue as the lead agency under the MOSS, as we had been previously on telecommunications. So we continue to do that.

We counsel, of course, with USTR, with the Treasury Department where there are investment aspects, and with other agencies as we go forward. So there is a review process. And in all of the formal MOSS negotiations, the agencies that are concerned with trade have representatives present, though usually our representative is the highest ranking of the members and conducts the negotiations.

I work very, very closely with USTR on almost everything. The two Deputy U.S. Trade Representatives and I have breakfast together every Friday morning that we are in town. We invite Clayton Yeutter and Secretary Baldridge to join us once a month, and we go over all the issues on the table, because we have to be so closely in harmony, whichever agency has the lead or whoever is doing what. Really, we are both involved in all of them.

Senator SIMON. At one point, President Reagan suggested the possibility of creating a Department of Foreign Trade—I am not sure that was the exact title he used—to achieve greater coordination and effectiveness. Is something like that still needed?

Mr. SMART. I think this question was asked, Senator, perhaps by you at a previous hearing. My own impression is that given the situation as we have it now, the way we are working is reasonably effective under the present conditions.

Obviously, many agencies are involved in trade. You cannot exclude the State Department or the Treasury Department or Agriculture or Defense or Energy or Transportation, let alone the White House agencies, and of course, USTR and Commerce are deeply in there.

So it would not be possible to create a Department of Trade and have that have the sole responsibility for these very complicated issues that go across the total fabric of our economy and our relationship with other countries.

On the other hand, I believe if we were starting from scratch, it would probably make sense to have the resources at least of my part of Commerce and those of USTR together. I think the coordination would be somewhat easier, and it would be easier to move people and activities around to meet the current situation than it is now where we come to the President through entirely different reporting lines.

Senator SIMON. Finally, I have had a bill drafted—let me just read you the significant sentence—that I am probably going to be introducing. It is not a trade barrier, but in a sense, informative to American automobile purchasers. It requires that each automobile offered for sale in the United States which has not previously been sold in the United States at a retail sale shall have prominently affixed to the automobile written notice indicating the approximate percentage of the automobile that was manufactured in the United States.

Do you have any reaction to that idea?

Mr. SMART. I think we would rather have the markets open to the best supplier, regardless of where he comes from, than to have anything that would indicate that some percentage was better than some other percentage. Obviously when you have less than one percent of the parts in a car, that does not look good enough to me. But I think I would be reluctant to do that.

We are going more and more into an internationalizing world, and how you would trace back that the part or the component was made in Japan, but it included semiconductors from Korea and steel from Taiwan and what-have-you, I think it would be very, very hard to do and really understand what you were getting at.

I am looking more at open markets than at a particular, previously-established result.

Senator SIMON. Any further questions, Senator Quayle?

Senator QUAYLE. No, thank you, Mr. Chairman.

Senator SIMON. Thank you very much, Secretary Smart.

Mr. SMART. Thank you.

Senator SIMON. Next we will have a panel composed of Mr. Bruce Bowden, Elliot Lehman, and John Riess.

I will ask my colleague, Senator Quayle, to introduce Mr. Bowden.

Senator QUAYLE. Thank you very much, Mr. Chairman.

It is my privilege to welcome Bruce Bowden—is it Bowden or Bowden?

Mr. Bowden. Bowden. I accept Bowden in the South.

Senator Quayle. Well, you are from Connersville, which is southern Indiana, close to it.

Unfortunately, I am going to have to depart. The Senate Armed Services Committee also has a hearing going on that started at 2:00 also. But I have your testimony, and it is quite on-target, and I am sure that the Chair will find this Hoosier insight to be quite precise, and we are glad to have you with us, and Mr. Thornton as well.

Thank you very much, and thanks for coming.

Thank you, Mr. Chairman.

Mr. Simon. Thank you.

Mr. Bowden?

STATEMENT OF BRUCE K. BOWDEN, VICE PRESIDENT, MARKETING AND PRODUCT DEVELOPMENT, STANT, INC., CONNERSVILLE, IN, ACCOMPANIED BY WILLIAM A. THORNTON, DIRECTOR OF ORIGINAL EQUIPMENT SALES; ELLIOT LEHMAN, CO-CHAIRMAN, FEL-PRO INCORPORATED, SKOKIE, IL, AND JOHN RIESS, GROUP VICE PRESIDENT, GATES RUBBER COMPANY, DENVER, CO

Mr. Bowden. Mr. Chairman, Members of the Committee, I am Bruce Bowden, Vice President of Marketing for Stant, Incorporated, a subsidiary of Purolator Courier. With me today is William Thornton, who is Director of our Original Equipment Sales for Stant.

I would like to thank you for the opportunity to meet with you today to discuss our company's concerns regarding the impact of the Japanese penetration of the U.S. auto market. Some background on Stant may be helpful in your understanding our concerns regarding the Japanese auto companies' trade practices.

Stant is a company which has concentrated its product efforts on automotive closure caps, primarily fuel and radiator caps. Stant is the largest manufacturer of automotive closure caps in the world, producing some 36 million caps per year. We supply 95 percent of the fuel cap requirements for the domestic automotive industry, and we supply 100 percent of Ford and Chrysler's radiator cap requirements. Stant is the primary source of closure caps to the agriculture industry as well as the military.

We are also the largest supplier of aftermarket closure caps in the United States. Stant has achieved this market position through product innovation—for example, we have had 65 patents issued in the last 10 years—continuing recapitalization of our asset base, a commitment to quality, and maintaining a competitive pricing structure.

We manufacture our products in two plants, one located in Indiana and the other in Arkansas. Total employment is about 700, with annual sales of approximately $50 million. It is apparent that while Stant is the major producer of its product, we are still a modest-size automotive parts company.

While we support and encourage the entire scope of the MOSS trade talks, we as a company are primarily concerned with marketing our products to the automotive manufacturers assembling vehicles in North America.

From a salesman's perspective, it is nonproductive to attempt to sell a product where no intent to buy exists. After examining the structure of the Japanese automotive market, we determined that licensing agreements with two Japanese manufacturers for their domestic requirements was the most logical action. These licensing agreements were primarily a result of the Japanese need for technological assistance and information in the manufacturing of emission and safety-related fuel caps.

Based on this need for technical assistance from the Japanese, we felt well-positioned to service the needs of those Japanese companies that were assembling or planned to assemble automobiles in the United States. And that is where we concentrated our marketing effort.

Now Bill Thornton, who was directly involved in this effort, will discuss this subject in more detail.

Mr. THORNTON. First let me say that to date, Stant has not supplied one part for a Japanese or Japanese-American joint venture vehicle assembled in the U.S. or Canada. We are a source of fuel caps for some vehicles built in Japan and exported to the U.S. for sale by a division of General Motors.

We have achieved some success, primarily with joint venture companies where our U.S. customer has specified our product, and we will begin supplying these customers when production starts.

However, one experience with a joint venture has resulted in over two years of delay after completion of tooling, pending approval of our product, while the Japanese source shipped over 200,000 caps into the United States. Part of the delay was a result of design changes which were incorporated into the vehicle and the Japanese-supplied fuel cap before Stant was informed of the changes.

We have made sales presentations where we have felt well-positioned to service a Japanese auto manufacturer in the U.S., in terms of competitiveness, quality, and proximity to their assembly plant, and were unable to obtain prints or specifications in order to submit a quote.

In one instance, we were told that the vehicle assembled in the U.S. was to be redesigned and we should focus our attention on the new model, which would be introduced in about six months. However, we would have to wait until the new model was introduced before we could see what type of fuel cap design was used and still no prints or specifications were available.

In January 1986, while attending a "Trading with Japan" conference organized by the Northeast-Midwest Congressional Coalition, we and other U.S. suppliers attending the conference were told by representatives of a Japanese company scheduled to begin U.S. production in late 1986 that initial production would be with Japanese-sourced components, as there was not sufficient time to develop American sources. This occurred over and one and one-half years before start of production. Recently, we were given the opportunity to quote radiator caps to a Japanese company building radiators in the U.S. However, we were given 48 hours to submit the quote, and no prints were available. Follow-up to the quotation resulted in our being told that "our price seemed a little high."

Mr. BOWDEN. From our perspective, we feel that it is absolutely imperative that the existing U.S. supplier base be accepted by the Japanese and Japanese-American joint venture companies. Failure to achieve this acceptance will mean continued and increased importation of Japanese components and establishment of more Japanese component manufacturers in the U.S.

While we and most U.S. auto parts suppliers do not fear competition and, in fact, have thrived in a highly-competitive environment, the specter of the Japanese suppliers with brand new facilities, operating in free trade zones, funded by over-eager State and local governments, and guaranteed business by their Japanese parent company, is not our concept of fair trade.

Our company is only one of hundreds of capable automotive parts manufacturers. In many ways, we are typical. We have strived to be competitive, quality-oriented, and productive. In fact, our Arkansas plant was awarded the first U.S. Senate productivity award in 1984 in that State. Both plants have received quality and performance awards from U.S. auto manufacturing companies.

If we as a country permit unchecked foreign capture of industries where surplus capacity already exists, at best we can expect dislocation with its resulting human problems, and at worst, permanent shift of employment and capital resources outside the U.S. borders.

Senator SIMON. Thank you.

[The prepared statement of Mr. Bowden follows:]

STATEMENT OF

BRUCE K. BOWDEN, VICE PRESIDENT OF MARKETING

AND

WILLIAM A. THORNTON, DIRECTOR OF ORIGINAL EQUIPMENT SALES

STANT INCORPORATED

PRESENTED TO

THE SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY

UNITED STATES SENATE

MARCH 30, 1987

March 27,1987

Mr. Chairman and Members of the Committee:

I am Bruce K. Bowden, Vice President of Marketing, for Stant Inc. and with me today is William A. Thornton, Director of O.E. Sales for Stant.

Thank you for the opportunity to meet with you to discuss our Company's concerns regarding the impact of the Japanese penetration of the U.S. auto market. Some background on Stant Inc. may be helpful in your understanding our concerns regarding Japanese auto company trade practices.

Stant is a company which has concentrated its product efforts on automotive closure caps, primarily fuel and radiator caps. Stant is the largest manufacturer of automotive closure caps in the world, producing some 36,000,000 caps per year. We supply 95% of the fuel cap requirements for the domestic automotive industry, and we supply 100% of Ford and Chrysler's radiator cap requirements. Stant is the primary source of closure caps to the agriculture industry and the Military. We are also the largest supplier of aftermarket closure caps in the U.S. Stant has achieved this market position through product innovation (For example: 65 patents in the last ten years) continuing recapitalization of our asset base, a commitment to quality, and maintaining a competitive pricing structure.

We manufacture our products in two plants: one located in Indiana and one in Arkansas. Total employment is 700 with annual sales of $50,000,000. It is apparent that while Stant is the major producer of its product, we are still a modest size automotive parts company. While we support and encourage the entire scope of the Market-Oriented Sector Specific (MOSS) trade talks, we, as a company, are primarily concerned with marketing our products to auto manufacturers assembling vehicles in North America. From a salesman's perspective, it is non-productive to attempt to sell a product where no intent to buy exists. After examining the structure of the Japanese automotive market, we determined that licensing agreements with two Japanese manufacturers for their domestic requirements was the most logical action. These licensing agreements are primarily a result of the Japanese need for technological information and assistance in the manufacture of emission and safety regulated fuel caps. Based on this need for technical assistance from the Japanese, we felt well-positioned to service the needs of those Japanese companies which were assembling, or planned to assemble, automobiles in the United States, and that is where we concentrated our marketing effort. William Thornton was directly involved in that effort and will address that subject.

William Thornton: First, let me say that, to date, Stant has not supplied one part for a Japanese or Japanese-American joint venture vehicle assembled in the U.S. or Canada. We are a source of fuel caps for some vehicles built in Japan and exported to the U.S. for sale by a division of G.M.

We have achieved some success, primarily in joint venture companies where our U.S. customer has specified our product, and we will begin supplying these customers when production begins. However, one experience with a joint venture has resulted in over two years of delay after completion of tooling, pending approval of our product, while the Japanese source shipped 200,000 caps into the United States. Part of the delay was a result of design changes which were incorporated into the vehicle and the Japanese-supplied fuel cap before Stant was informed of the changes.

We have made sales presentations where we felt well-positioned to service a Japanese auto manufacturer in the U.S.,in terms of competitiveness, quality, and proximity to their assembly plant, and were unable to obtain prints or specifications in order to submit a quote. In one instance, we were told that the vehicle assembled in the U.S. was to be redesigned and we should focus our attention on the new model, which would be introduced in about six months. However, we would have to wait until the new model was introduced before we could see what type of fuel cap design was used, and still no prints or specifications were available.

In January 1986 while attending a "Trading with Japan" conference organized by the Northeast-Midwest Congressional Coalition, we, and other U.S. suppliers attending the conference, were told by representatives of a Japanese company scheduled to begin U.S. production in late 1987 that initial production would be with Japanese-sourced components, as there was not sufficient time to develop American sources. This occurred over one and one-half years before start of production. Recently, we were given the opportunity to quote radiator caps to a Japanese company building radiators in the U.S. However, we were given forty-eight hours to submit the quote, and no prints were available. Follow-up to the quotation resulted in our being told that "our price seemed a little high".

BOWDEN: From our perspective, we feel that it is absolutely imperative that the existing U.S. supplier base be accepted by the Japanese and Japanese-American joint venture companies assembling vehicles in the U.S. Failure to achieve this acceptance will mean continued and increasing importation of Japanese components, and the establishment of more Japanese component manufacturers in the U.S. While we, and most other U.,S. auto parts suppliers, do not fear competition and, in fact, have thrived in a highly competitive environment, the specter of Japanese suppliers with brand new facilities, operating in free trade zones, funded by over-eager state and local governments, and guaranteed business by their Japanese parent company, is not our concept of fair competition.

Our Company is only one of the hundreds of capable auto parts manufacturers in the U.S. In many ways we are typical, continually striving to be competitive, quality oriented, and productive. Our Arkansas plant was awarded the first U.S. Senate Productivity Award in 1984. Both plants have received quality and performance awards from our U.S. automotive manufacturing customers.

Our Company's strategy in the past has been to invest in U.S. facilities, hire U.S. workers, and service our market fairly and competitively. We would like the opportunity to continue this strategy. If we, as a country, permit unchecked foreign capture of industries where surplus capacity already exists, at best, we can expect dislocation with its resulting human problems; and, at worst, permanent shift of employment and capital resources outside the U.S. borders.

Senator SIMON. Next, I am pleased to say we have a witness from Illinois, Mr. Elliot Lehman, the President of FEL-PRO, Incorporated, from Skokie.

Mr. Lehman?

Mr. LEHMAN. Thank you, Senator.

Our firm is a closely-held family-managed company. We manufacture primarily gaskets and sealants used in internal combustion engines and are sold primarily in the U.S. and Canada with some additional export activity. I might add that as of this moment, we sell nothing to the Japanese automotive industry.

Approximately 70 percent of our products are distributed through the independent automotive aftermarket. The balance is sold to vehicle and engine manufacturers and some industrial maintenance outlets. In 1986, we did approximately $185 million worth of business and employ 1,700 people.

I would like to confine my remarks almost exclusively, if I may, to the State incentives and how we feel about them.

I might also start at the outset to indicate that up to the present time, there is no direct Japanese gasket manufacturer who has established facilities in the U.S. I might also state that what products of ours that come in are not being used on an assembly line inasmuch as the engine and the power trains come into our country completely assembled and are then put into the assembly plants in toto.

The potential problem of our industry of State incentives was brought clearly to my mind in February of 1986, when the Wall Street Journal carried a feature article, the headline of which read "A Gathering Glut—Auto Industry Faces Era of Plant Closings Due to Overcapacity." This came out simultaneously with a tremendous amount of media attention given to the Governor of Illinois James Thompson's efforts towards attracting component manufacturers to the State in order to serve the Diamond-Star assembly plant, which is a joint venture between Mitsubishi and Chrysler.

I later sent to your office, Senator, a report prepared by the U.S. and Foreign Commercial Service of the American Embassy in Tokyo, dated April 25, 1986. Contained in this report is a statement that within the next three years, 300 Japanese automotive component manufacturers would be opening in the U.S., and they would be assisted by financial incentives from States and localities. Included is a paragraph urging American manufacturers to take steps to protect their interests.

I might say that the State has been very helpful to us in trying to explore this problem, and they arranged a meeting at which some of us were represented. Among the points that the manufacturers made to the State were the following:

There is excess capacity in Illinois and in other States for the manufacture of automotive parts, and that what was being accomplished was not creating employment, but merely changing its location.

We also pointed out the fact that Japanese distribution techniques direct that their spare parts are distributed through their own dealer organizations. Many of us in the room at that time are dependent upon already-established networks of independent wholesalers and repair shops, many of whom have already been suffering because of the great increase in the number of Japanese vehicles on the road, and we are not getting what we would consider our fair share of the repair parts for those vehicles.

You have already heard about "keiretsu" and therefore there is no need for me to expand on that. The manufacturers in the room did not take issue with "keiretsu". However, we said that if there is "keiretsu", that is should not be done at the expense of local manufacturers; and that if there were cultural preferences that the Japanese manufacturers may have, they should not be catered to with special incentives.

We all felt that we were being treated unfairly, particularly in view of the fact that tax dollars that we had paid into the State were being used to establish potential competitors.

We also made the point that the incentives that were being offered would result in lower operating costs for the transplant because of the nature of the incentives and the transplants' ability to structure manufacturing processes without the limitations of previously installed equipment and facilities.

I feel that this is truly a national problem. Why? Because the States are having bloody warfare between themselves. And they mention, I think with good reason, that if Illinois does not do something in Illinois, then Indiana will do it, Kentucky, Maryland, or whatever State it would be, and that therefore this has to be a problem that the Federal Government has to address.

You have already heard about the statements that we manufacturers are not capable of producing quality up to their standards. I believe this is a smokescreen. We have proven to various representatives of the Commerce Department, and I can expand on this at any time you wish, that our quality is equal to any in the world. It has been so recognized by no less than General Motors and Ford.

Senator SIMON. Go ahead and finish your statement.

Mr. LEHMAN. The one thing I would say is that if I would suggest what I would like the Federal Government to attempt to do would be as follows—taking into consideration the fact that as the Secretary of Commerce told us recently, that he has to be concerned with the concept of States' rights—and that is that I would discuss with the States, with all of the attention that you can bring to bear on it, both in the media and by Government analysis, that their activities are counterproductive, they are expensive, and they are dislocating. If incentives are to be given, they should be based upon realistic uniform criteria that would reflect true needs, such as a shortage of capacity and a true inability to meet standards or specifications.

We also know that there is a tremendous amount of Federal moneys available to the States in the incentives they give and that Federal power should not be used to withhold Federal assistance that is given to the States for economic development if it is unwarranted by the facts.

I would also like to state here and now that I hope that nothing I have said can be construed as being anti-foreign investment or anti-foreign associations. All we want is a level playing ground.

I would also like to state that contacts that we have recently made with both Japanese and German counterparts has given rise with us to a cautious optimism that we can become a supplier to some Japanese OEM plants being established in the U.S. and in other places such as Mexico.

Thank you.

Senator SIMON. Thank you very much, Mr. Lehman.

[The prepared statement of Mr. Lehman follows:]

TESTIMONY TO BE PRESENTED TO THE U.S. SENATE SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY

My name is Elliot Lehman. I am Co-Chairman of FEL-PRO Incorporated located in Skokie, IL. We are a closely held family managed company. Our firm manufactures primarily gaskets and sealants used in internal combustion engines and are sold primarily in the U.S. and Canada with some other export activity. Approximately 70% of our products are distributed through the independent automotive aftermarket. The balance is sold to vehicle and engine manufacturers and some industrial maintenance outlets. In 1986 we had a volume of approximately $185,000,000 and employ 1700 people.

In your letter of March 2nd, you requested that I testify both on behalf of FEL-PRO and as an industry representative. Although I am aware of the MOSS talks, I have not participated in any of the deliberations, and therefore, would hesitate to comment upon them. Therefore, I will confine my remarks only to the effects of state incentives to attract industry and concentrate on the incentives to Japanese automotive component manufacturers. Up to the present time, no Japanese gasket manufacturer has established facilities in the U.S. However, if and when engines are assembled in the U.S., this condition will change as it already has for other automotive parts.

I became aware of the increasing severity of the potential problem to our industry of state incentives in February of 1986 when The

Wall Street Journal carried a feature article, the headline of which read "A Gathering Glut - - Auto Industry Faces Era of Plant Closings Due to Over Capacity." This article came out simultaneously with media attention given to Illinois Governor James Thompson's efforts toward attracting component manufacturers to the state in order to serve the Diamond Star assembly plant which is a joint venture between The Mitsubishi & Chrysler organizations. My interest was further heightened by receipt of a copy of a report prepared for the "U.S. and Foreign Commercial Service, American Embassy, Tokyo" dated April 25, 1986. Contained in this report is a statement that within the next three years, 300 Japanese automotive component manufacturers would be opening in The U.S. and they would be assisted by financial incentives from states and localities. Included is a paragraph urging American manufacturers to take steps to protect their interests. (I submitted a copy of this report to Senator Simon's Chicago Office.)

In order to explore the ramifications of Illinois' activities I contacted various state officials. They cooperated in arranging a meeting on November 24, 1986, at which time a cross section of industry representatives discussed the issue with members of Governor Thompson's staff.

Among the points that the manufacturers raised were the following:

1. There is excess capacity in Illinois and in other states for the manufacture of automotive parts.

2. Because of this excess capacity, the manufacturing plants that were being established were not creating employment, but merely changing its location.
3. The new companies that were being established for reasons outlined later on, ostensibly to supply the new Japanese automotive assembly plants, would also supply their spare parts. The practice particularly of Japanese automotive manufacturers is to have their suppliers make parts available only through their dealers. This would work to the disadvantage of the already established network of independent wholesalers and repair shops. This distribution channel has already been hard hit on this very issue because the preponderance of repair parts used to service Japanese vehicles are being imported from Japan.
4. It was pointed out that Japanese companies prefer to deal with Japanese suppliers. (Japanese car manufacturers frequently own, in whole or in part, their principal component manufacturers and maintain sole source contracts.) The U.S. manufacturers did not take issue with their attitude, but felt their cultural preferences should not be catered to with special incentives. Whatever the circumstances that prevailed for U.S. owned industry should apply to the transplants. The manufacturers felt they were being treated unfairly particularly in view of the fact that tax dollars they had paid into the state were being used to their potential disadvantage.

5. Incentives being offered would result in lower operating costs for the transplant because of the nature of the incentives and the transplants ability to structure manufacturing processes without the limitations of previously installed equipment and facilities.

The State Officials were sympathetic but indicated they had no alternative but to continue their action since other states were doing the same thing and that Illinois manufacturers and taxpayers would be hurt either way and possibly more so if the plants located in other states. (Facts bear them out). They also indicated their figures showed they would get a 10% payback per year on the state's and locale's investment. It was not mentioned whether or not this figure included lost revenues in the form of unemployment compensation payments, and reduced income taxes from companies already doing business in Illinois.

They also stated that the state did have various financial incentives available to U.S. manufacturers. (Further analysis indicated that while this was true, they were of less magnitude than those being offered to the transplants).

Since that time, additional information has been obtained which lends further emphasis to points made above. The State incentives in the form of tax abatements, tax incentives, land and utility concessions, low or no interest loans, provide competitive price advantages to newly established firms. As stated above, this works to the competitive disadvantage of U.S. corporations, which can lead to the loss of business with resultant social dislocation experienced in the localities that are adversely affected.

In recent meetings held with The Commerce Department and The Government Accounting Office, the point was made by both of them that Japanese transplants are necessary because of Japanese car makers claims that U.S. component manufacturers cannot meet the quality and delivery standards of the Japanese vehicle manufacturers. Even if this were true (which it is not) it would act as a reason for the foreign investor to open a facility here without the need for financial help. As far as quality is concerned, our company, and I'm sure others, have amply demonstrated to Commerce Department officials and others our ability to equal or surpass quality standards established anywhere in the world. Our company has received awards from Ford, General Motors, and Cummins Engine indicating our over-all excellence in meeting their ever rising standards for delivery and quality.

I will close by saying that I feel there is some merit in the states attitude that if one state doesn't take these steps others will. Therefore, there is a role for the Federal Government to play that can perhaps end or at least temper this war between the states. I have these suggestions to offer:

1. Discuss (with suitable facts and media attention) with the states that their activities are counter-productive, expensive, and dislocating.
2. If incentives are to be given, they should be based upon realistic, uniform criteria that would reflect true need such as shortages of capacity, inability to meet standards or others.
3. Use federal power by the holding back of federal assistance that is given to the states for economic development if it is unwarranted by the facts.

I hope that it is not construed that I and my company are anti-foreign investment or anti-foreign associations. However, we feel strongly that we and they should be handled fairly and equitably. In conclusion I will add we have recently made contacts with both Japanese and German counterparts that has given rise to a cautious optimism that we can become a supplier to some Japanese OEM plants being established in the U.S. and our private interests and those of the nation will be protected and improved.

Thank you for your attention.

Senator SIMON. The last witness in this panel is Mr. John Riess, of Gates Rubber, Denver, Colorado.

Mr. RIESS. Thank you, Mr. Chairman.

I am John Riess, Group Vice President of the Gates Rubber Company of Denver, Colorado. I am also the current Chairman of the Motor Equipment Manufacturers Association, located in Englewood Cliffs, New Jersey.

The Gates Rubber Company is a family-owned private corporation which has been in business since 1911. We are international in our operations, with plants located in England, Germany, Belgium, Mexico, Canada and Brazil, and a joint venture in Japan. In addition we have 19 plants which are located in the United States, two of which, Mr. Chairman, are in the State of Illinois.

Our primary products are mechanical rubber products, which are V-belts and hose, fiber products, and small batteries. Our largest market is the automotive market, both original equipment and replacement parts.

Overall, our experience with the transplants to date has been pretty good. Currently, at Nissan, in Smyrna, Tennessee, were are the 100 percent radiator hose supplier and have been selected as the belt and power steering hose supplier. At Honda in Marysville, Ohio, we are in the final stages of selection on radiator hose and timing belts. We have two small parts at Toyota and have a letter of intent for radiator hose at Nummi in California. However, Diamond-Star in Illinois is planning on bringing in most parts from Japan, as is Mazda in Michigan.

I suspect that our success is different from other suppliers in that to date, most of the engines and drive lines are brought in intact from Japan. Our products, especially hose, are difficult to ship, so it gives us the advantage to being locally situated. In each case, it has taken about 18 months to be finally selected to begin shipping parts to these transplants.

All sourcing decisions for our products have been cleared with Japan, and in Nissan's case, Marvin Runyan, who runs the Smyrna operation, had to sign off after it cleared in Japan.

Another major difference in working with the Japanese vehicle transplants compared to domestic manufacturers is the lack of design input. You are told what to furnish even if, in some cases, there is a better alternative.

I must point out that so far, none of the suppliers in Japan competitive with Gates have built a plant in this country. This factor, combined with the cost of shipping our types of products, may be the reason for our early success. What will happen when the Japanese transplant our competitors to the United States remains to be seen.

This brings me to the second issue that I was asked to discuss—what are the effects on our business of the foreign-owned parts manufacturers in Illinois. To date, and to the best of our knowledge, only one direct competitor has indicated they are coming, and that is Mitsuboshi Belting, Limited, of Japan. As you well know, Mr. Chairman, the location of Mitsuboshi in your home State of Illinois has been the subject of much discussion and could well be the basis for your hearing today.

We at Gates have taken exception to this plant. Our exception is not based on the fact that a Japanese competitor is locating in the U.S., because we have competed with MBL around the world for years, but to the manner in which it is here. We protest the incentives that the State of Illinois provided MBL, and my full statement outlines those, Mr. Chairman.

This was done in order to secure a projected 150 new jobs, which possibly could approach 250 over the next four years.

We are opposed to the use of public funds which in effect are taxpayers' funds, to subsidize new manufacturing capacity, that as a result gives Mitsuboshi an unfair cost advantage in the production of their products. While in the short term, this may provide a few new jobs, it is our position that ultimately, it will cost jobs to the State and later to the country.

It has been said that the new Mitsuboshi belt plant has under contract 70 percent of the Mitsubishi car factory belt business. We would submit to you that if this in fact is the case, the new belt factory would come to Illinois without any State incentives, and the move could still be based on sound business decisions.

As you can see, if the new MBL plant has guaranteed business already, the addition of State incentives gives them a further pricing advantage. It only stands to reason that our ability to compete has been further damaged.

From a national point of view, our position is that the problem of subsidization of business to entice location of facilities into individual States and communities is causing unfair competition and economic waste.

The basic responsibility of Government is to support an economic environment that provides equitable opportunities for all businesses and to remove impediments which stifle private initiatives and not create them.

I would defer any other further comments, Mr. Chairman, as outlined in my statement.

Senator Simon. Okay. Your full statement will be entered in the record.

[The prepared statement of Mr. Riess follows:]

STATEMENT BY

JOHN RIESS

GROUP VICE PRESIDENT
THE GATES RUBBER COMPANY
DENVER, COLORADO

AND

CHAIRMAN
THE MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION
ENGLEWOOD CLIFFS, NEW JERSEY

BEFORE

EMPLOYMENT AND PRODUCTIVITY SUBCOMMITTEE
LABOR & HUMAN RESOURCES COMMITTEE
U.S. SENATE

MARCH 30, 1987

I am John Riess, Group Vice President, the Gates Rubber Company, Denver, Colorado. I am also the current Chairman of the Motor & Equipment Manufacturers Association located in Englewood Cliffs, New Jersey. The Gates Rubber Company is a family-owned private corporation which has been in business since 1911. We are international in our operations with plants located in England, Germany, Belgium, Mexico, Canada and a joint venture in Japan. In addition, we have 19 plants located in the United States.

Our primary products are mechanical rubber products (V-belts and hose), fiber products, and small batteries. Our largest market is the automotive market, both original equipment and replacement parts.

I have been asked to address Gates experience with the Japanese transplants in the United States, the effects of the foreign-owned manufacturers in Illinois on our business and, finally, our view on the recently concluded Moss Plenary. Overall, our experience with the transplants to date has been pretty good. Our success, as a general rule, has started with hose and has moved gradually into other products.

Currently, at Nissan, in Smyrna, Tennessee, we are the 100% radiator hose supplier and have been selected as the belt and power steering hose supplier. At Honda in Marysville, Ohio, we are in the final stages of selection on radiator hose and timing belts. We have two small parts at

Toyota and have a letter of intent for radiator hose at Nummi in California. However, the Diamond Star in Illinois is planning on bringing most parts in from Japan as is Mazda in Michigan.

I suspect that our success is different from other suppliers in that, to date, most of the engines and drive lines are brought in from Japan. Our products, especially hose, are difficult to ship so it gives us an advantage to be locally situated.

In each case, it has taken about 18 months to finally be selected and to begin shipping parts. All sourcing decisions for our products have to be cleared with Japan and, in Nissan's case, Marvin Runyan, who runs the Smyrna operation, has to sign off _after_ it is cleared in Japan.

Another major difference in working with the Japanese vehicle transplants, compared to domestic manufacturers, is the lack of design input. You are told what to furnish even if, in some cases, there is a better alternative.

I must point out that, so far, none of the suppliers in Japan competitive with Gates have built a plant in this country. This factor, combined with the cost of shipping our types of products, may be the reason for our early sales successes. What will happen when the Japanese transplant our competitors to the United States remains to be seen.

That brings me to the second issue I was asked to discuss--what are the effects on our business of the foreign-owned parts manufacturers in Illinois? To date, and the best of our knowledge, only one direct competitor has indicated they are coming, and that is Mitsuboshi Belting, Ltd., of Japan. As you well know, Mr. Chairman, the location of Mitsuboshi in your home state of Illinois has been the subject of much discussion, and could well be the basis for your hearing today.

We at Gates have taken exception to this plant. Our exception is not based on the fact that a Japanese competitor is locating in the U.S., because we have competed with MBL around the world for years, but to the manner in which it is here.

We protest the incentives that the state of Illinois provided MBL.

These incentives included a $2 million loan from the "Build Illinois" Fund to build this plant and, while the interest rate on the loan is still be negotiated, according to Governor Jim Thompson, the interest rate could be as low as zero percent. In addition to the "Build Illinois" incentive, the state is also committed to providing $500,000 in state and federal monies for employee training, plus matching funds to build an access road to the plant.

The package of incentives went on to include some from the City of

Ottawa which would approach another $900,000 and would include a 30-acre site where the factory is to be built. Ottawa would also offer additional tax breaks.

This is being done in order to secure a projected 150 new jobs, possibly approaching 250 over the next four years.

We are opposed to the use of public funds which, in effect are taxpayer's funds, to subsidize new manufacturing capacity that, as a result, gives Mitsuboshi an unfair cost advantage in the production of their products. While, in the short term, this may provide a few new jobs, it is our position that, ultimately, it will cost jobs to the state and later to the country.

It has been said that the new Mitsuboshi belt plant has under contract 70% of the Mitsubishi car factory belt business. We would submit to you that, if this is in fact the case, the new belt factory could come to Illinois without any state incentives and the move still be based on sound business decisions.

As you can see, if the new MBL plant has guaranteed business already, the addition of state incentives gives them a further pricing advantage. It only stands to reason that our ability to compete has been further damaged.

From a national point of view, our position is that the problem of subsidization of business to entice location of facilities into individual states and communities is causing unfair competition and economic waste.

The concern of the Gates Rubber Company is not directed specifically at subsidies for foreign investments, but also to the transfer of domestic facilities only to achieve the use of public subsidies.

The basic responsibility of government is to support an economic environment which provides equitable opportunities for all businesses and to remove impediments which stifle private initiatives -- not create them.

Congress is, right now, developing legislation to encourage fair and open trade. The issue of government subsidies of new business should become part and parcel of the new trade laws.

There are no short-term solutions to the current situation. The need for job creation is serious and complex, but the trend of state and local governments to use our own tax revenues, which has the effect to give an unfair advantage to one business over another, is not the answer.

All business within the United States -- and all levels of government--federal, state and local-- must recognize and jointly work for elimination of plant site subsidization to business.

Finally Mr. Chairman, you have asked for my views on the recently completed MOSS plenary session. Let me preface my remarks by noting that my views are based on information provided me by various staff of the Motor & Equipment Manufacturers Association who are directly involved in various advisory capacities on the MOSS talks.

I think it has become clearly apparent the Japanese are reluctantly participating in the MOSS process with regard to automotive parts because they view this as a private sector problem, not involving any government trade barriers. As a result, the Japanese government, or MITI, negotiators have stubbornly resisted any concessions or agreements for over seven months.

Finally, at the recently completed plenary MOSS round, the Japanese accepted, in principle, a reporting procedure that could begin to assemble baseline data. Hopefully, that data can be developed in the necessary detail to identify both the positive and negative areas of Japanese procurement practices, particuarly with U.S. parts manufacturers. I feel safe in saying the industry views this as a positive development and we urge both the U.S. and Japanese negotiators to move as quickly as possible on the parameters and criteria for collecting and reporting that data.

In the aggregate, I'm not sure of what the MOSS talks can further accomplish in the few months remaining for negotiations. The high visibility given the issue might develop some additional business for U.S. parts manufacturers, but even those could be short-lived contracts as the Japanese continue to transplant their vehicle supplier industry with guaranteed OE contracts and the assist of incentives from our own governments.

As a parts manufacturer, and a member of our domestic industry, I am concerned. Mr. Chairman, that once the MOSS process on auto parts concludes in August, the issue will move from the spotlight of center stage to the darkness of the backstage. As a result, the pressure will be off the Japanese to break down their traditional cultural barriers that protects their domestic industry.

I am not here to advocate protectionist or draconian measures for our industry, but I do believe there is a need to keep the pressure on the Japanese to open their procurement practices. One suggestion I would make is that Congress be kept informed on a semi-annual basis of the progress being made by U.S. parts manufacturers in selling the Japanese vehicle manufacturers, both as original equipment and replacement parts distributed through each manufacturers Service and Sales Divisions.

These data could be an extension to the agreement made in the MOSS talks and would provide Congress with the basis for making a determination on appropriate legislation, if required, to protect U.S. technology and jobs, in the U.S. motor vehicle parts industry.

Mr. Chairman, thank you for the opportunity to appear before you today. On behalf of the Gates Rubber Company and MEMA, let me thank you for conducting these hearings and giving us a forum to discuss our issues with you. I would be happy to respond to any questions you, or other members of the subcommittee might have.

Senator SIMON. Mr. Bowden, first, just a word of commendation. I notice that you mention in your statement you had 65 patents in the last ten years. One of the things, clearly, that we have to do more of is research. One of my reasons for being one of three people to vote against the tax bill was the reduction that we have to firms like yours to do research. We clearly have to be doing a much better job.

You say in your statement, "From a salesman's perspective, it is nonproductive to attempt to sell a product where not intent to buy exists." How do you judge there is no intent to buy? What signals do you get?

Mr. BOWDEN. Well, in the international scene, it is not only Japan. We do not get signals from Europe or Mexico or a lot of countries. Most of them support their own industries, and they are much more nationalistic than the United States. And in the case of Japan, they already have a very close relationship with their current suppliers; they are happy with them. It is very costly for us as a small company to go over and try to interject ourselves into the engineering and design decisions.

So I think it would be very difficult to sell into the Japanese market.

Senator SIMON. And when the Japanese talk about our lack of quality—and I recognize no one is going to say the quality we produce is not a good one—but is in fact quality a consideration in your products? Do you really think that is really a reason Japan or West Germany or——

Mr. BOWDEN. Not in our product. Our product has to meet Federal specifications for emission control and safety requirements, crashability, all legislated automotive requirements. We 100 percent test every one of our products to meet specifications. And in the case of the Japanese, they came to us licensing our technology, so we assumed that we were known as a good quality source. And we do supply all of the major car companies in the United States. We supply Rolls Royce, and they certainly have a high quality reputation. So I do not think in our instance, quality is an issue at all.

Senator SIMON. Mr. Lehman and Mr. Riess, you both have talked about the need to not have States bringing in plants that are in fact putting American plants out of business.

You have both reflected on this. How does the Federal Government provide leadership on that problem?

Mr. LEHMAN. Well, certainly, I expound on that much more thoroughly in my written report. But the point is that the Federal Government has a role in this. I mean, for instance, just one small example I could use would be job training. I know that Illinois has given very substantial job training incentives to the Diamond-Star plant, and I think also to the Mitsuboshi plant.

Well, now, if an organization already has trained people who do not have to be trained at a big cost, and you are putting in a new plant in another location where for whatever reasons our people will not relocate, the other people are going to be trained, and then it is going to create unemployment, which then creates in a sense unemployment insurance where the Federal Government is, and it also is going to make it necessary for the Government to support retraining of the people who are unemployed.

So therefore, the Federal Government does have a voice as to how these moneys are being expended. For that reason, I think that is true. I also know that there are certainly, from what I understand—and this is not an area where I am an expert—the Federal government does give incentives for UDAG, I think it is called, and things of that kind, where the Federal government does have a role. And why should the Federal Government be not "monitoring"—which is a word I heard used today—monitoring how their funds that go to the States are being used. And in this case, I believe that there is a possibility that they will be used uneconomically.

Senator SIMON. Mr. Riess?

Mr. RIESS. I would add just briefly to what Elliot said in that I feel that part of the incentives that have been given have included some Federal training funds. Whether or not that is the intent or the purpose of those funds I think is an area that should be looked at.

I would also suggest that possibly as an oversight that the Federal Government has a responsibility to keep the States from possibly destroying themselves as they continue this wild bidding back and forth, because any industry that has excess capacity that you create new equipment, new trained workers, unfair advantage, it is going to cost those jobs that are already there, and it will probably fall back on the Federal Government at that point.

Senator SIMON. Mr. Lehman, you say, "We have recently made contacts with both Japanese and German counterparts that has given rise to a cautious optimism that we can become a supplier." Is that getting to be at a point where it is really tangible? Do you think there is going to be a shift in this ability to supply abroad?

Mr. LEHMAN. Well, let me answer this in another way. You know, I believe that economics should play a role in all of these areas, and I have said to various government agencies that I think it is unrealistic to think that we are going to be able to ship with the many miles between us to the Japanese assembly lines, particularly when they have a very highly-developed gasketing industry of their own.

However, there comes a time now when there are things that we are developing that they have not developed, for instance, in the environmental area, where we are much further advanced in the elimination of asbestos as a ceiling product. They are interested in that. So that I think there is a kind of synergism here between the devaluation of the dollar and environmental concerns and the fact that we have made what we consider to be the most encouraging kind of contacts between us and some of the Japanese auto factories.

Up until now, you have heard the horror stories which have been stated here about how many times all of us have met with various Japanese companies and the variety of responses that we get, but none of them which has resulted in anything but lip service.

I use the word "cautious" optimism only by virtue of the fact that I think that finally, we have come to a point where there is enough going for us that serves their needs as well as our desires that I can be cautiously optimistic.

Senator SIMON. Mr. Riess, you say, "Our products, especially hose, are difficult to ship so it gives us an advantage to be locally situated." And then you say, in a different paragraph, "The Diamond-Star in Illinois is planning on bringing most parts in from Japan, as is Mazda in Michigan."

In just pure economic terms, if you were the manager of the Diamond-Star plant or the Mazda plant in Michigan, and you just wanted to get a product for the least amount of money—a quality product—it would make sense, as I gather from your statement, to purchase from you rather than bringing in the Japanese products. Is that correct, or is that not correct?

Mr. RIESS. Certainly on hose products, Senator. With hose products, you ship a lot of Japanese air if you bring them this way. Belts, you can stack them and do some other things to make them ship more efficiently.

That is why I believe that we have always gotten the start—one of two reasons we have gotten the start—on hose products, is the fact that we are here, the fact that it is easier to get hold of. And in many cases the belt products come as part of the engine in certain cases; they are already assembled on the engine. So they basically or virtually get them for free if they ship them that way.

But if I were going to be the Diamond-Star manager and was going to buy radiator hose, obviously, you could do it cheaper from the U.S. than you could from Japan, I would think, at this point.

Senator SIMON. One final question to each of you. Are you satisfied with the progress of the MOSS talks. The next meeting is in April, another meeting in August. Is this moving along as expeditiously as you think is desirable?

Mr. Bowden?

Mr. BOWDEN. Well, Senator, from my perspective, I do not think they are moving along rapidly enough, and they certainly have not been very productive to date.

But as I mentioned before, our main concern is protecting the business that we have here in the United States as opposed to trying to break the barriers into Japan, because I think without wild incentives and free trade zones and those types of unfair competition, that like Mr. Riess has said, it makes sense for them to come to us; it would be cheaper to buy from us that to ship it over from Japan.

Senator SIMON. Mr. Lehman?

Mr. LEHMAN. I have not been involved in these things, Senator, but I know that Mr. Riess has, and I would like to defer to him.

Senator SIMON. Mr. Riess?

Mr. RIESS. Well, my remarks would be—again, I have not been totally involved with them—but only as Chairman of MEMA, and I asked the staff to put together the comments that appear in the statement, and that would be the only comments I could make.

It appears that it has been a very slow process.

Senator SIMON. We thank you very, very much for your leadership in bringing jobs to our country and for coming here today to help inform us of what we should be doing.

Thank you very much.

I am going to reverse the order of the last two panels and bring on Congresswoman Marcy Kaptur from Ohio and Congressman Sandy Levin from Michigan, before our final witness.

Let me again commend the two of them for their leadership in this whole area.

Representative Kaptur.

STATEMENT OF HON. MARCY KAPTUR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO; AND HON. SANDER M. LEVIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Ms. **Kaptur**. Thank you, Mr. Chairman, for allowing myself along with Congressman Levin to appear before your Committee today to address ourselves to foreign direct investment in the motor vehicle industry in the United States.

Though the handle of foreign investment is jeweled, it is a sword with many sharp edges. I view the current situation as serious to our nation's economic health and its future well-being as serious as the struggle of our machine tool and semiconductor industries to ward off buyouts by foreign firms in the interests of national security.

The auto industry is the bellwether of where the United States is headed industrially. Almost two million people are employed because of motor vehicle production, and we know that over one-third of the vehicles sold in America last year were imports, and if the dollar value of production is calculated, more like one-half of last year's automotive production was foreign-made, and I commend you for the legislation that you are considering introducing on import labelling.

Over half of the United States truck industry is now foreign-owned, as is 25 percent of the machine tool industry. Foreign direct investment in the manufacture of motor vehicles and equipment increased more than twofold between 1980 and 1985, rising from a total of $686 million to $1.5 billion. The 1986 figures, when released, are likely to show a threefold increase just in the last seven years.

Already, over 70 automotive supply and assembly plants have set up operations in the United States, and more than 300 additional Japanese supplier firms are lined up in Tokyo waiting for entry into our market. Overcapacity will rue the day.

In fact, Harvard economists tell us by 1990, there will be four million more automobiles targeted at the U.S. market than this economy can absorb.

By 1988, the Japanese will have the capacity to build 1.5 million vehicles in the United States in addition to the 2.3 million imported from Japan. This year, our Big Three can expect to sell only about 10.5 million vehicles, one million fewer than in 1986 and 25 percent fewer than they have the capacity to build.

Detroit now has the equivalent of ten too many domestic assembly plants and is currently in the process of closing plants across the nation.

I represent a port city in the heartland of America that is dependent on foreign trade. Yet in Northwest Ohio, over 4,000 more manufacturing jobs were lost just last year due to overcapacity being created in our marketplace by foreign transplants and unfair foreign trade practices.

Why is it that one-half of the U.S. auto market is foreign dominated, but in Japan, the world's second-largest market economy, foreign auto imports from any country account for less than 3 percent of annual sales?

I have found it most instructive to learn how difficult it has been for many U.S. firms to receive reciprocal access to foreign-based companies with operations in our country. More than 75 percent of the value of Japanese-assembled cars in our country is composed of foreign-made parts.

Recent press stories that indicate Japanese practices may be changing soon are clearly motivated by the ongoing auto talks with Japan, which started last August, that we in Congress struggled so long to initiate.

What you have is the cozy "keiretsu" relationships we have tolerated thus far in this country with tight assembler-supplier vertical integration which would be disallowed under our antitrust laws.

If Japan does not enforce its own antitrust laws on the books, we should enforce the laws for them.

Mr. Chairman, my statement makes specific recommendations on actions the Senate might consider to strengthen in the trade bill that is being considered here the references to the MOSS talks, and I will leave to my colleague Mr. Levin more specific references to that, as well as to certain actions that might be taken here on the Canadian-U.S. auto trade talks, because it is very important that the auto issue be laid on the table in those talks, since we are very concerned about strong incentives for foreign countries to manufacture in Canada and then ship auto parts into the U.S. practically duty-free.

I would rather concentrate the remainder of my remarks in three areas—Foreign Trade Zones, State/local incentives, and finally, Congressional oversight in two areas.

Senator SIMON. And I would add your full statement will be entered in the record.

Ms. KAPTUR. Thank you.

Foreign Trade Zones were created in 1934 by an Act of Congress to "encourage and revive the foreign trade of the United States." Step by step, the original intent of Foreign Trade Zones has been whittled away, from one of export promotion to import inundation.

Today, a company with Foreign Trade Zone status can import a good, manufacture it into a finished product, and sell the product in the domestic market while paying a substantially lower duty than if the product had been imported directly.

Even though Foreign Trade Zones were intended to create employment and exports, at present over 80 percent of the goods being imported into Foreign Trade Zones are used in domestic commerce.

There are about 85 approved subzones, with 41 being automotive-related. There are 55 zone and subzone applications pending, of which six are auto assembly plants and five are automotive supplier plants. In addition, 85 percent of all subzone activity is automotive-related, and 86 percent of those goods enter domestic commerce.

A Foreign Trade Zone can encompass the entire manufacturing facility as is the case with the GM-Toyota Nummi plant in Fremont, California. While one effect of existing zone practice is to provide economic benefits to zone manufacturers in the local area, the net effect of such practices is a loss of tariff protection to domestic suppliers. Through the misuse of the trade zone principles, the various tariff acts of Congress are effectively repealed.

In 1984, the GAO prepared a study to analyze this issue. We do not even know the exact dollar value of imported goods flowing from the current zones into domestic commerce, though I can assure you it is staggering.

It will soon be requested of the GAO to update their earlier study. I suggest a moratorium on all new Foreign Trade Zone approvals, certainly in the auto industry, until we have a better grasp on the workings of these zones, and whether or not their function supports our national interest over the long term.

Let me turn to State and local incentives for investment.

It is perplexing to see U.S. States falling over themselves in Tokyo to lure more Japanese foreign direct investment by offering incentives that have the effect of giving foreign-owned companies an unfair advantage to produce over American-owned companies, many of which are in need of modernization.

In fact, the Kentucky Legislative Research Commission recently analyzed that incentives offered to Toyota cost that State $125 million over 20 years, or $42,000 per job. I would suggest to you, Mr. Chairman, that you look seriously at this haphazard struggle for foreign direct investment by various localities to see if we really are better off nationwide because of it, or have we experienced a net displacement and a loss of jobs and ultimate control due to foreign company business structures where decisions and high-value-added production take place in the home country, not in the U.S.

Finally, in terms of Congressional oversight in two areas, I would strongly support a reporting mechanism through the USTR that would closely monitor all foreign investment in the United States, requiring them to include a statement of impact on our national economy that is expected because of that intended investment.

I commend to you broadening legislation by Congressman John Bryant just added to the House trade bill, which requires full disclosure of the interests behind all major foreign investment in the United States. At a minimum, the United States should know who is investing in its agriculture, manufacturing and defense bases.

Second, I would suggest Congressional oversight and a careful study of the pattern of foreign investment practices allowed in the United States compared to other nations, such as Japan. It should examine the practices of other nations that attempt to control such things as joint ventures and majority-minority ownership, methods of financing, tax accounting cost of production, and the extent to which foreign-sourced materials are used in exports generated from transplants.

Mr. Chairman, we really look forward to working with you as we confront these serious and important issues, and would welcome any questions after Mr. Levin has completed his testimony.

Senator SIMON. Thank you very, very much.

[The prepared statement of Ms. Kaptur follows:]

TESTIMONY OF

CONGRESSWOMAN MARCY KAPTUR

BEFORE THE SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY

COMMITTEE ON LABOR AND HUMAN RESOURCES

UNITED STATES SENATE

MARCH 30, 1987

Mr. Chairman, thank you for allowing me to appear before you today to discuss foreign direct investment in the motor vehicle industry. Though the handle of foreign investment is jeweled, it is a sword with many sharp edges.

FOREIGN INVESTMENT IN THE AUTO INDUSTRY

I view the current situation as serious to our nation's economic health, and it's future well-being, as serious as the struggle of our machine tool and semiconductor industries to ward off buyouts by foreign firms in the interests of national security. I find it interesting that the plight of the U.S. semiconductor industry is commanding so much attention of late (well-deserved I might add), when in fact over 3/4 of its business is with the auto industry. The auto industry is a bellwether of where the U.S. is headed industrially. Almost 1.8 million people are employed because of motor vehicle production! We know that over 1/3 of vehicles sold in America last year were imports and if the dollar value of production is calculated, more like 1/2 of last year's automotive production was foreign made. Over half of the U.S. truck industry is now foreign-owned, as is 25% of the machine tool industry.

It is clear that the Japanese have planned to saturate our market with automotive parts production and motor vehicle assembly to replace American-owned production. Foreign direct investment in the manufacture of motor vehicles and equipment increased more than two-fold between 1980 and 1985, from $686 million to $1.536 billion! The 1986 figures, when released, are likely to show a three-fold increase just in the last seven years. Already, over 70 automotive supply and assembly plants have set up operations in the United States. More than 300 additional Japanese suppliers firms are lined up in Tokyo waiting for entry into our market. Overcapacity will rue the day.

Are we to stand idly by over the next three critical years and see what has already happened with agricultural overcapacity happen to another U.S. industry? By 1988, the Japanese will have the capacity to build 1.5 million vehicles in the United States, in addition to the 2.3 million imported from Japan. This year, the Big Three can expect to sell only about 10.5 million vehicles -- one million fewer than in 1986 and 25% fewer than they have the capacity to build. Detroit now has the equivalent of 10 too many domestic assembly plants and is currently in the process of closing plants across the nation.

As you know, I represent a port city in the heartland of America that is dependent on foreign trade. Yet in northwest Ohio, over 4,000 more manufacturing jobs were lost just last year, due to overcapacity being created in our marketplace by foreign transplants and unfair foreign trade practices. Why is it that 1/2 of the U.S. auto market is foreign dominated but in Japan, the world's 2nd largest market economy, foreign auto imports from any country account for less than 3% of annual sales?

My district symbolizes the plight of the automotive supplier industry. Centrally located, our companies have supplied the Big Three and the replacement markets both in the U.S. and abroad for many years. We have our share of quality suppliers. So I have found it most instructive to learn how difficult it has been for many of these firms to receive reciprocal access to foreign markets and to foreign-based companies with operations in the United States. More than 75% of the value of Japanese assembled cars in the U.S. is composed of foreign-made parts. There is no strong indication that Japanese transplant operations are significantly changing their buying habits. Equal access is clearly not found in the transplanted foreign plants, most of which are Japanese-owned. In fact, the recent press stories that indicate Japanese practices may be changing soon are clearly motivated by the ongoing auto parts talks with Japan which started last August that we in Congress struggled so long to initiate.

Limited access is standard Japanese operating procedure. American automotive suppliers are kept off their purchasing lists. I have heard far too many stories of American companies who were not given specifications for parts, but were expected to bid against Japanese-owned suppliers based in the U.S. or in Japan who had the specifications. In fact, what you have is the cozy keiretsu relationships we have tolerated thus far in this country, with tight assembler-supplier vertical integration which would be disallowed under our anti-trust laws. Japan should enforce its own anti-trust laws on the books, or we should enforce the laws for them.

MARKET-ORIENTED SECTOR SPECIFIC TALKS

I am truly disappointed with the lack of progress on the MOSS Talks. Statements of intentions are meaningless if not backed up by clear methods of measuring sales volume and explicit timetables for action. And we know that even if goals are set, as was the case in the telecommunications negotiations, Japan has clever ways of avoiding the bottom line. So I am reserving final judgement until the Talks are completed this summer. I recommend you include a section in the Senate trade bill similar to the House provision on MOSS Talks which expresses the sense of the Congress that the success of the negotiations will be seen in significant increases in purchases by Japanese companies from U.S. parts suppliers.

CANADIAN-U.S. AUTO TRADE

In addition to careful monitoring of the MOSS negotiations, we must also be certain that the Canadian Auto Pact and the Canadian duty remission scheme be laid on the table at the U.S.-Canada Free Trade Talks. Under the current duty remissions program, non-North American companies that establish a manufacturing facility or increase auto parts procurement in Canada for export purposes are then eligible for a partial duty refund on vehicles eventually exported to Canada. This gives a strong incentive for foreign countries to manufacture in Canada and ship auto parts into the U.S. practically duty-free. Canadians fear not only scrutiny of their duty remissions program, which appears to be GATT-illegal, but also of a number of safeguards included in the Auto Pact.

FOREIGN TRADE ZONES

The impact of Foreign Trade Zones is an area ripe for analysis. Foreign Trade Zones were created in 1934 by an Act of Congress to "encourage and revive the foreign trade of the United States." Opposition to FTZs was based primarily on arguments that they would promote imports to the detriment of American manufacturers. Step by step, the original intent of FTZs has been whittled away, from one of export promotion to import inundation.

Today, a company with FTZ status can import a good, manufacture it into a finished product (or even put it in a slightly different form), and sell the product in the domestic market while paying a substantially lower duty than if the product had been imported directly. In addition, duties are not paid on the good until it leaves the subzone, and property on zone grounds is exempt from ad valorem taxes in most states. Even though Foreign Trade Zones were intended to create employment and exports, at present, over 80% of the goods being imported into FTZs are used in domestic commerce. There are about 95 approved subzones, with 41 being automotive related. There are 55 zone and subzone applications pending, of which 6 are auto assembly plants and 5 are automotive supplier plants. In addition, 85% of all subzone activity is automotive related, and 86% of those goods enter domestic commerce.

Vehicle and component transplants simply add to existing U.S. manufacturing capacity. Since these transplants are mainly assembly operations, with high value components being sourced overseas, there is a net loss of U.S. jobs. A foreign trade zone can encompass the entire manufacturing facility, as in the case of the G.M.-Toyota (NUMMI) plant in Fremont, California. While one effect of existing zone practice is to provide economic benefits to zone manufacturers and the local area, the net effect of such practices is a loss of tariff protection to domestic suppliers. Through the misuse of the trade zone principles, the various tariff acts of Congress are effectively repealed.

In 1984, the GAO prepared a study to analyze this issue. We do not even know the exact dollar value of imported goods flowing from the current zones into domestic commerce, though I can assure you it is staggering. However, the number of approvals and applications pending warrant an updated look at this program. It will soon be requested of the GAO to update their earlier study. I suggest a moratorium on all new foreign trade zone approvals, certainly in the auto industry, until we have a better grasp on the workings of these zones, and whether or not their function supports our national interest over the long term.

STATE AND LOCAL INCENTIVES FOR INVESTMENT

It is perplexing to see U.S. states falling over themselves in Tokyo to lure more Japanese foreign direct investment by offering incentives that have the effect of giving foreign-owned companies an unfair advantage to produce over American-owned companies, many of which are in need of modernization. Too many home-grown companies are left out to dry and are ending up out of business. It doesn't take much to figure that a new plant that receives free roads, free land, free employee training, low interest loans, and grants will be able to make a cheaper product and thus beat out an established firm in the market. For example, the Kentucky Legislative Research Commission recently analyzed that incentives offered to Toyota cost $125 million or more over 20 years, or $42,000 per job. I would suggest to you, Mr. Chairman, that you look seriously at this haphazard struggle for foreign direct investment by various localities to see if we really are better off nationwide because of it, or have we experienced a net displacement and a loss of jobs and ultimate control due to foreign company business structures where decisions and high-value added production take place in the home country, not in the U.S.

One approach I am confident we in the House will approve is a provision that has been added to the reauthorization of the UDAG program by my colleague from Minnesota, Congressman Bruce Vento which would prohibit certain uses of UDAG funds for business relocation. The use of UDAG funds to attract foreign investment is expressly prohibited if it is determined that market share or operations of a domestic business entity would in any way be diminished.

This summer, the GAO will complete a report on foreign investment in the U.S. which I requested last fall, in conjunction with Congressman John Dingell of Michigan. It will arrive none too soon. The study has taken longer than expected, due to the difficulty in gathering what most companies consider proprietary information, such as data regarding profits, capital flows, taxes, and profit-related leveraging ratios for reinvestment in the U.S. Because Japan's financial structure is so different than that in the U.S., the debt servicing and interest rates associated with many of these transplants is quite different than the experiences of a U.S. corporation.

ANALYSIS OF FOREIGN DIRECT INVESTMENT

Capital investment issues have long range impacts on a nation's self sufficiency. It is beyond me how some of our negotiators can believe that the best strategy to achieve U.S. economic pre-eminence is to keep our markets totally open, so that other nations won't close theirs any more - the so called national treatment issue. Foreign markets must be opened to American products and investments. It should be obvious that within a couple of years, we will have nothing left to negotiate with if we hold true to this policy of benign indifference. Foreign companies and governments will control our market as well as theirs if we don't move with dispatch. In this regard, I would strongly support a reporting mechanism through the USTR that would closely monitor all foreign investment in U.S. manufacturing. In each case, companies would have to clearly state their economic objectives, and include a statement of impact on our national economy that is expected because of the intended investment.

I also commend to you legislation by Congressman John Bryant just added to H.R. 3, the House Trade Bill, which requires full disclosure of the interests behind all major foreign investment in the United States. At a minimum, the U.S. should know who is investing in its agriculture, manufacturing, and defense bases.

As your Committee moves forward in crafting legislative proposals to deal with this issue, I suggest a careful study of the pattern of foreign investment practices allowed in the United States compared to other nation's such as Japan. It should examine the practices of other nations in regarding joint ventures and majority-minority ownership, methods of financing, tax accounting cost of production, and the extent to which foreign-sourced materials are used in exports generated from transplants.

I look forward to working with you as we confront these issues, and would welcome any questions you have at this time.

Senator SIMON. Congressman Levin?

Mr. LEVIN. Thank you very much, Mr. Chairman. It is a real pleasure to be here with you, a former colleague and a much-admired member of this august body.

We now in the House can refer to you by name—as long as we say only nice things, I think is the rule. But in your case, that is all we would say, anyway.

Let me, if I might, follow on from Marcy's comments.

We have been working on this together for a year and a half now. It was about a year and a half ago that we were in Japan, and we sat down with representatives of six manufacturers. Several of them brought their books and spread them out.

Our question was a simple one: How much are you buying from American companies?

The results were very precise. In those days, there was not any effort to hide or to obscure the figures. When we added them up—and it was easy to do that—at a time when there were about $13 billion worth of sales in the U.S., the purchases by Japanese companies for production there was about $100 million worldwide—worldwide.

And our worst fears were confirmed in dollars and cents, down to the last—to mix currencies—yen. And I thought it might be most useful if I would just, if I might, give you a few reactions to the journey that has been followed in these last 18 months or so.

In a sense, we have come a long way, but much more on the calendar than we have in terms of real change. But here are some observations. My testimony in writing has been submitted, and I know under your rules, it will be placed in the record for posterity.

Senator SIMON. It will be.

Mr. LEVIN. Let me instead just give some observations, because Marcy Kaptur and I in a sense have been living and eating auto parts, starting with that sparkplug that Marcy Kaptur brought to Japan.

First of all, let no one argue that we are saying there is a single factor. It is often said, well, you are saying if they open up their markets, the deficit will go away. We have never said that. And I hope that every time it is raised, there will be a quick answer: Forget it. We are not saying that.

The question of access is one of the questions and one of those that has to be answered.

Secondly, expect from the other person to hear every reason for a situation except that they are responsible. If the shoe were on the other foot, we would probably do the same thing, as you astutely observed earlier. But do not take that characteristic with a grain of salt, the failure to ascribe any fault to oneself, but remember it, I think, vividly.

We have heard talk about quality to the end of time. And it is a factor. But I was just looking over the annual report of the Eaton Corporation, one of the largest auto parts manufacturers in the world. They sell to Mercedes, to BMW, you name it. I do not know all the details. But one detail I do know. Essentially, for Japanese cars, there has been a curtain—an iron curtain—and piercing it has been exceptionally difficult even for those firms whose hallmark includes quality.

Thirdly, as we approach this we have to understand the differences between the way we do business in this country and other countries. There is a different governmental-private sector nexus in other countries, and there is a different nexus between and within countries, and we have to understand that.

That is why Marcy Kaptur and others and myself in the legislation that is now out of committee in the House inserted a provision into 301 to take into account private sector activities within the Japanese motor vehicle industry.

You know, for a producer here in this country, they do not really care if it is a tariff or if it is a private relationship if they sell zero. The result is the same. And a private relationship can be tougher to surmount than a governmental barrier.

Fourthly, in my judgment, looking back at the last 18 months, we in this country have paid a high price for Congress being so to speak the fist and the Administration the glove; or, to put it another way, Congress the protectionist, unfairly ascribed, and the Administration the free trader. What is the Administration today, having moved on semiconductors? Are they the protectionists?

We paid a price for that. First of all, in the MOSS talks, the story has been only quietly told, and maybe it had better be left that way. But it took some real doing to force, to stimulate, the Administration to elevate these auto parts issues to the MOSS talks level. And most seriously, other countries do not take us seriously when it is Congress that is pressuring and the Administration that is holding back. Why? Because there is a feeling that they can always turn to the Administration, to "Uncle Ronald" or whoever, to pull the chestnuts out of the fire. And I want to emphasize that.

Fifthly, I also want to underline in the judgment of several of us—I think many of us—the need in MOSS talks and everywhere else for there to be some objectives set, some goals put together.

Secretary Smart earlier said that their interest is in access; there is no predisposition to set how much should come out of access. We have worked closely with Secretary Smart and admire his efforts. That is the Administration line, though, and it has some frightful shortcomings, in my judgment and in the judgment of many others.

First of all, if you do not set goals, it is pretty hard to determine whether you are making progress. What is the measuring rod?

And secondly, others do not take us very seriously when we do not have some goals. In a word, we need some affirmative action in the area of trade. And there has to be some affirmative action not with quotas, at least with some objectives and with goals. You sat with Mr. Kuroda a month ago, with Ms. Kaptur and myself. We sat there, and he was asked the question, "Is the Japanese market as open to American auto parts manufacturers as the American market is open to Japanese manufacturers?" And he looked us in the eye and said, "Yes." One of the unbelievable responses of this year, if not this decade.

It just is not true. And if we do not take the broader approach to trade and set some goals and put some of the onus on those who know their own system to meet those objectives—not the entire burden, but some of it—we are not going to make very much progress.

You know, it is interesting. Here we have an economy, Mr. Chairman, where the emphasis is on the bottom line—right—the short-term profit and loss statement. We criticize ourselves for that. But when it comes to international trade, we are unwilling to do that even on a longer-term basis. We are entrepreneurs, it seems to me, in just about everything except our economic relations with other nations, and we simply have to change that.

And my last comment, I think Ms. Kaptur has said it so well as you and others have. We hardly have a policy. It is hard to know what it is. We have Foreign Trade Zones, which were supposed to save jobs for America, right? And now it seems to be a major instrument in cases to destroy those jobs.

We have State incentives. If I were on another side, I would be laughing or chuckling quietly at what is going on. It is a system of divide and conquer. Let the antagonist fight among itself.

And we are doing that, and it is understandable that we are in the absence of any kind of a policy.

And a final comment on the lack of a policy. One of our strengths is diversity. But diversity can also breed decline. And that is what is happening in the auto parts industry, looking back these last 18 months. We have to put our house in order, and it does not mean all the decisions being made here. That is not what we have in mind at all, but some kind of set of policies with some kind of objectives, clearly understood by those who have with us $60 billion in trade surpluses, and it has been getting worse.

So with Congresswoman Kaptur, I salute these efforts, Mr. Chairman. This endeavour to get hold of our policy is a joint effort between the Senate and the House and hopefully, increasingly the Administration. It is long overdue.

Thank you very much.

[The prepared statement of Congressman Levin follows:]

TESTIMONY OF

HONORABLE SANDER M. LEVIN

MEMBER OF CONGRESS

BEFORE THE SUBCOMMITTEE

ON

EMPLOYMENT AND PRODUCTIVITY

OF THE

SENATE LABOR AND HUMAN RESOURCES COMMITTEE

MONDAY, MARCH 30, 1987

Mr. Chairman, thank you for taking the initiative to look closely at the dismaying bilateral trade problem between Japan and the United States in the auto-parts sector. Your prominent role in Congressional monitoring of the current auto-parts negotiations with Japan has given much greater weight to the concerns we in Congress have been voicing as these negotiations have proceeded. I deeply appreciate the opportunity to testify today on this critical trade issue with my House colleague Congresswoman Marcy Kaptur.

The MOSS Talks

Marcy Kaptur, my colleagues Nancy Johnson and Lynn Martin, and I have taken a leading role in the efforts of a Task Force on Auto Parts made up of 27 House members. We have been pressing the Administration for some time to give high priority to the auto-parts issue in bilateral talks with the Japanese. Last May these efforts bore some preliminary fruit. Our negotiators requested and the Japanese agreed that the auto-parts industry should be the subject of a new round of Market-Oriented, Sector-Specific trade talks (like the previous rounds on telecommunications, medical equipment/pharmaceuticals, forest products, and electronics).

The auto-parts negotiations have been under way since last August. So far the progress has been minimal. It has taken six months and four negotiating sessions just to get a Japanese commitment to "consider" how to collect and report data on the purchases of American-made parts by Japanese vehicle manufacturers--data that are essential to measure progress in opening access to the Japanese parts market.

However, on the fundamental premise of the auto-parts talks, from the American standpoint--the existence of exclusionary procurement policies that severely restrict the Japanese market for U.S. parts--the Japanese evidently have not budged. The only semblance of movement on this fundamental issue has been a joint statement of the negotiators after the February talks, which said that "the important tests of our accomplishments include a significant increase in sales by U.S. auto parts companies to Japanese vehicle companies" and "the initiation of long-term sourcing relationships between U.S. parts companies and vehicle companies." But the statement does not acknowledge that Japanese market-access barriers stand in the way of such accomplishments.

The fact is that Japan's major vehicle manufacturers do follow exclusionary procurement policies. There are exceptions, but the basic pattern clearly has been one of dealing only with Japanese parts makers. American companies that are supplying high-value-added components for use in Mercedes, BMWs, Volvos, and Saabs cannot make a sale to the Japanese. These policies are tolerated by the Japanese government. They are reflected in the dramatically limited U.S. exports of auto parts to Japan--a couple of hundred million dollars a year, throughout the 1980s.

Indeed, in inflation-adjusted terms, the Japanese are importing no more U.S. auto parts than they did in 1980, even though many U.S. companies are offering competitive products and have made sustained efforts to penetrate the Japanese market. Over the same period, Japan's parts exports to the United States have risen several billion dollars, even if you leave out the billions of dollars in parts used in Japanese assembly plants located within foreign trade subzones here.

The Japanese negotiators and industry spokesmen would have us believe that the problem is simply our American misunderstanding of their ways. Typical is the comment of Kinya Shinoyima, general manager of the materials and parts department of the Japan Automobile Manufacturers Association, featured in a recent JAMA publication. Shinoyima argued that "the friction between U.S. auto parts producers and Japanese auto manufacturers could be overcome if U.S. parts producers understood the fundamental structural differences between the U.S. and Japanese auto industries and how these differences affect the way automakers and suppliers do business."

I am afraid that U.S. parts makers understand all too well. As Dutch journalist Karl van Wolferen, a veteran observer of Japanese economic policy, recently wrote in a Foreign Affairs article entitled "The Japan Problem":

> In this context it is useful to know what in Japan is meant by "understanding." The Japanese connotation of this term is acceptance or tolerance. You show true understanding of people or things by accepting them they way they are if you are not strong enough to change them. If you have strength, the other party will show understanding by a certain degree of adaptation to your wishes. Foreigners who keep on protesting about Japanese trade methods in spite of the many Japanese explanations demonstrate their lack of understanding....

Trade Amendments

The House Ways and Means Committee, on which I serve, last week approved two amendments I offered to the House trade bill, both of which are intended to show our country's firm resolve to quit being so damned understanding about Japanese trade barriers. One of these amendments refers directly to the current MOSS talks on auto parts. It would express the sense of Congress that success in "overcoming substantial market access barriers" in auto parts "will be measured by a significant increase in sales by United States auto parts companies to Japanese vehicle companies and the initiation of long-term sourcing relationships between such companies." The resolution also would direct the U.S. Trade Representative and the Department of Commerce to report to Congress on the outcome of the talks and on any agreements reached. The amendment explicitly addresses not only access to the Japanese home market but also access to the market for original and replacement parts associated with Japanese automobiles produced in the United States and third countries.

The other amendment, which I also commend to your favorable attention, would expand the coverage of our law on unfair trade practices to get at the type of systematic anti-competitive practices that our auto-parts companies have encountered in Japan. Under this amendment to sec. 301, adopted without dissent by the Ways and Means Committee, a foreign government's toleration of systematic anti-competitive practices that restrict access of U.S. goods on noncommercial grounds would be defined as an "unreasonable practice," warranting either a negotiated settlement or U.S. retaliation.

I firmly believe that only a credible threat of swift and sure retaliation will convince the Japanese it is in their interest to negotiate a speedy end to unfair practices in auto parts and other sectors. I would be delighted to see a breakthrough in the MOSS talks that would assure some genuine and prompt results. But I agree with those in the Administration, like Bruce Smart, who have said that the sector-specific approach is not getting the job done and who call for "wholesale solutions." I believe that we in the Congress should heed that call as we consider comprehensive trade legislation.

Foreign Investment

An important weakness of the Administration's approach to the MOSS talks has been skittishness about addressing the issues posed by the increasing presence of Japanese vehicle and parts manufacturing in this country. Japanese vehicle manufacturers are being followed over here by their families of parts suppliers, in great numbers. Indeed, the auto makers are urging their traditional parts suppliers to join them here. For example, the Japan Economic Journal recently reported that Mazda, which will soon open a plant in Flat Rock, Michigan, is calling on its affiliated Japanese parts suppliers to move plants to the United States. In starkest terms, the concern is that an industry already marked by excess capacity will face even greater excess capacity, squeezing out many currently viable, American-owned firms.

To state the concern another way, are we going to find that Japanese-owned firms, substantially using sub-components built back in Japan, will displace production by U.S.-owned firms using mostly U.S.-built components? This could be the future facing U.S. parts producers and U.S. workers in the parts industry.

Unfortunately, in the MOSS talks on auto parts the Commerce Department's negotiators have been too shy about raising this question, even for purposes of collecting the information needed to get an accurate picture of the procurement pattern of Japanese manufacturing subsidiaries.

This lack of even basic data bearing on the net economic impact of foreign investment in auto parts and other sectors makes intelligent policy-making well nigh impossible. We simply have got to have this type of information.

Foreign Trade Zones

One of a number of Congressional fact-finding efforts designed to fill this information gap will be a forthcoming request, from Ways and Means trade subcommittee chairman Sam Gibbons, for General Accounting Office and International Trade Administration studies of the economic impact of foreign trade zones. Most motor-vehicle manufacturing in America now occurs inside these customs-free enclaves. Foreign components enter the zones duty-free, to be installed in vehicles on which a lower duty applies when they enter the U.S. domestic market.

One notable effect of these foreign trade zones, which were originally intended to promote exports of U.S. goods, is to encourage the importation of foreign auto parts on a grand scale. This amounts to a unilateral trade concession granted by the United States to producers from countries that are at the very same moment stoutly defending their barriers against the import of U.S. parts. Purely in terms of trade-negotiating strategy, this strikes me as a perverse U.S. policy.

It may be that, trade-negotiating strategy aside, the pluses to the U.S. economy can be shown to outweigh the minuses of foreign trade zones. But right now that positive economic impact is an unexamined premise of the foreign-trade-zone program. The time for re-evaluating this program is ripe.

Policy Chaos

The lack of coherent national policy is compounded by state and local economic-development policies that offer myriad inducements to foreign manufacturers to expand their production capacity in the United States. We have witnessed for some years an embarrassing scramble by state and local officials to outdo each other in offering public subsidies for foreign investment. Again, it may be that the pluses of the resulting investment outweigh the minuses, but the point is that nobody is weighing the net impact on the national economy of these inducements granted to foreign investors. The focus is almost exclusively on local economic impact, without regard to the potential for displacement in other localities (and often enough without much apparent consideration of giving equivalent investment incentives to American firms already established in the area). The consequence is policy chaos, at a time when our nation urgently needs a coordinated trade strategy.

This foreign-investment example is just one more illustration of the policy disarray with which we have responded to the rapid globalization of markets. We are taking a terrific beating right now from countries like Japan that systematically promote exports and inhibit imports, while we keep our markets remarkably open and watch domestic industry after domestic industry join the endangered-species list.

In industry after industry, dwindling market share means a diminishing command of the resources that make technological innovation possible. Unless we can force a change in the winner-take-all trade strategy of key trading partners like Japan, we will slip behind decisively, for generations, in our ability to create decent jobs and a decent quality of life for our people.

Our counterstrategy has to recognize that we are up against mercantilist trade policies. It must be strong enough to shock those mercantilist countries into a recognition that we will retaliate for unfair practices unless their promises of change are borne out by results. It is time for those countries to "understand" us--in the Japanese sense of the word.

Once again, Mr. Chairman, I thank you for inviting me to testify. I look forward to working with you on these related issues of trade and the economic impact of foreign investment. I want to applaud your linkage of these two topics in this hearing and your recognition of the critical need for better information on foreign investment as a basis for sound policy. I hope the Administration takes your cue.

Senator SIMON. I thank you both very much.

Let me ask both of you kind of a broad philosophical question. There are those who say let us face it, the United States is now moving toward becoming a service-oriented society, an information society. In a very real sense, that was kind of the philosophy behind the tax bill that was passed last year.

How do you respond to that?

Ms. KAPTUR. It takes a lot of patience for me to respond to that and not become angry. I have always felt that service jobs were derivative jobs. I did not support the tax bill as authored last year, because I felt that it was counterproductive to capital investment that needed to occur in many of our wealth-producing industries—our heavy manufacturing and agriculture—and I think that time will show that in fact—and is already showing—that investments have not been made and have been deferred or not made at all, and we have a lot more financial transactions occurring in the economy just because that is sort of the easy route to go, and you are not getting the volume of investment you need in many of these industries to keep them productive and competitive in the United States.

I think all of the studies show that if you look at high-tech—and I find it interesting that the Administration has finally selected on semiconductors in which to at least wave a little club internationally—three-quarters of the semiconductor industry's business is with the automotive and motor vehicle industry, and semiconductors have always been regarded as kind of clean and high-tech and not "dirty" like those manufacturing businesses that have oil on the floor and ceiling at the end of the day sometimes that they have to clean up.

So I think many of the jobs that are spun off from industry and from agriculture, finance jobs, legal services jobs, different types of maintenance jobs that are termed service jobs, are in fact derivative jobs. And we are just beginning to understand that we cannot survive as a service economy if one looks at the average wage level over the last several years, the jobs that have been created during the Reagan years in the service sector; overall their hourly rate is much lower than jobs that are created in the manufacturing sector. And I think the reason is because they are in fact derivative jobs; they are less able to produce new value and real wealth. So most of the service jobs are derivative jobs. So I do not agree with that, and I think the country is coming to see it in a different way as well.

Mr. LEVIN. Mr. Chairman, we have much to learn from other countries. We ought to go back and read, I think it was in "Business Week", their review of American competitiveness. They quoted several distinguished industrialists in Japan, and here is what they said, to paraphrase—that those who control production ultimately will control technology; that those who control implementation will ultimately control innovation.

Senator SIMON. And to maintain a quality of life in this country, then, we have to encourage the manufacturing sector more.

Mr. LEVIN. Sure. This is what we need to face up to. I do not think we ought to only argue about whether service jobs are very different in wage profile and the rest from industrial jobs. That is a critical issue, whether we have slipped behind in our standard of living because of that factor. But there is another factor, and that is what is the future of America without a strong industrial base, in terms of our military position but as critically in terms of our basic economic strength.

Senator SIMON. I could not agree more.

You said we ought to be setting goals. I am a great believer in setting goals. What kind of goals would you like? We are at one percent right now in the Japanese market, for example. What kind of a goal should we be setting?

Mr. LEVIN. Well, you know, a goal was set in 1980. There were discussions between the countries about this industry. And a goal was set then that was superseded by the so-called voluntary restraints. If we would adopt that and adjust for inflation, it would be $1 billion plus now per year.

I am not sure, and I do not mean that we should set rigid goals. You know that by this year, there has to be exactly so much, the following year so much. But I think we ought to set some reasonable objectives what the trend-line should be and essentially say to the Japanese and to others, "You have that much of the burden."

I might mention Mr. Smart a few weeks ago said just this. He said, "We need to find wholesale solutions." We just cannot be retailing ourselves, just nibbling away at this. And then, when he was asked as to what they may be, he said, "I will have to punt," because the Administration opposes goals.

But I would think that in addition to information and monitoring, which we need, we should sit down with, in this case, the Japanese, and set some kind of reasonable increments. And I think going up by six, seven, eight hundred million dollars in the next year, maybe something around the billion dollar level, is a reasonable target to set. We can always change it.

Senator SIMON. If I may ask both of you, are you satisfied with the speed of the MOSS talks?

Ms. KAPTUR. I might make a comment on that, Mr. Chairman. Mr. Levin has much more experience in international relations than do I, and he has been the patient one in the group. I never believed that we would get anywhere anyway, but I have sort of gone through it hoping that the best would come out. I really think he deserves a lot of credit for helping to push these talks ahead and convincing members like myself to stay on the ship.

I have been extremely disappointed with the progress of the flow of the trade talks to date. I look at the amount of effort that our own Administration is able to put into it and the experience of those doing the negotiations versus the experience of those negotiating on behalf of Japan's firms, and I become somewhat concerned. I am not pleased at all with the interim agreement that was announced a few weeks ago when they were here in Washington. It seems to be a lawyer's delight. You can read anything into any word you want to, but the bottom line is they do not come out with anything.

The only specific auto part that is mentioned in the interim agreement just so happens to be sparkplugs, which makes one who comes from a district that manufactures sparkplugs and who made it an issue in her trip to Japan somewhat suspicious as to why this of all of the 22,500 parts you can use in an automobile would be mentioned in this rather loosely-worded interim agreement.

So I am not really pleased with the pace of the talks nor with any kind of concrete resolution.

I also, knowing that the Japanese firms have a $25 billion share of the U.S. market, and that even today, I think Honda is only looking at an additional eight suppliers to supply product into their Marysville plant, I think $1 billion worth of value into the production either in Japan or here is almost laughable, and yet we would consider that a great achievement. I certainly do not think it would be a great achievement at all to have $1 billion worth out of $25 billion, and yet we are left to fight for crumbs.

So I would be much more by the year 1990, in my own mind at least, looking for half. I do not think that that is unreasonable, and I do not think that the current pace of the trade talks is going to lead us to that, however.

Mr. Levin. Mr. Chairman, I am very disappointed. The Japanese were dragging their feet even about a monitoring device. They said they did not want to agree to say how much they were buying, even though when we were there a year and a half ago, they spread their books and told us exactly what they were buying.

I think there is a lesson to be learned in the last few days, and that is either there is action or else. And I hope that our allies on non-economic matters—they are really our allies on economic matters in the long run—will understand it.

One-half of our deficit with Japan is in the motor vehicle area, and that represents a substantial portion of the overall deficit we have, two-fifths. So about one-fifth of it is in motor vehicles with one country. And these talks have been a crawl when they had better be a run. We will see in the next months what the Administration can produce and in large measure, not totally, that is going to depend on whether the Japanese are more forthcoming.

Senator Simon. I thank you both for your leadership, and Representative Kaptur particularly on the Foreign Trade Zone, you are getting us all more informed in that area. And I think, Representative Levin, you kind of summed up the mood of Congress with the "or else". I think there has to be action or the Congress in a way that may not be wise, may not be prudent, is going to take some very, very solid steps.

It would be wise of our friends from Japan to move on their own very quickly to accommodate change.

Thank you both very, very much.

Ms. Kaptur. Thank you, Mr.Chairman.

Mr. Levin. Thank you very much for this opportunity.

Senator Simon. Our final witness is Mr. Alex Warren, Vice President for Administration, Toyota Motor Manufacturing of Lexington, Kentucky.

Mr. Warren, first of all, I apologize for keeping you to the end. I have just been handed a note. We have a roll call on the Floor, so we are going to have about a 15-minute recess, and I apologize for that delay.

[Short recess.]

Senator Simon. The Subcommittee will resume its hearing.

We are pleased to have Mr. Warren here. And again, I apologize to you, Mr. Warren. That is kind of the nature of things around here.

Mr. WARREN. No problem, Mr. Chairman.

Senator SIMON. Please proceed.

STATEMENT OF ALEX WARREN, JR., VICE PRESIDENT, ADMINISTRATION, TOYOTA MOTOR MANUFACTURING USA, INC., LEXINGTON, KY, ACCOMPANIED BY JEFF SMITH, LIAISON MANAGER

Mr. WARREN. My name is Alex Warren, and I am Vice President of Toyota Motor Manufacturing USA, known as TMM. I am accompanied by Jeff Smith, our Liaison Manager from Lexington, Kentucky.

TMM is the company that has been established to build the automobiles at Toyota's $800 million auto plant now under construction near Georgetown, Kentucky. When we reach full production sometime in 1989, our Kentucky plant will produce 200,000 Camrys a year. We will directly employ 3,000 people. All but about 50 of those will be Americans.

To place our procurement goals and activities in context, let me begin with a brief description of the basic concepts behind our management philosophy at TMM.

First of all, we want to combine the best of Toyota with the best of America in establishing a new business operation that is firmly based in the United States.

Second, we want to contribute to the development of the Commonwealth of Kentucky and to the United States' economy in general by providing capital resources, securing parts and materials, transferring the very latest technology, expanding employment opportunities and increasing the pool of tax revenues.

Third, and probably most pertinent to your inquiry today, Toyota is firmly committed to maximizing U.S. content at the start-up of production and to continue increasing that content into the future. This will be done without compromising our product quality standards.

U.S. procurement has a distinct economic advantage in terms of lower transportation costs and more effective communications with our suppliers.

So for these reasons, when quality, cost and delivery flexibility are competitive, the ball is going to roll toward U.S. suppliers.

The parts selection process for TMM began many months ago. We produced more than 1,000 drawings and a 1,500-page compilation of specifications in English and provided several hundreds of thousands of dollars worth of sample parts for local suppliers to analyze. We also conducted a preliminary survey of about 1,200 North American parts and material suppliers, including all suppliers who had indicated a desire to do business with us.

We then formed a study team of purchasing, engineering and production specialists, and they visited about 180 of these companies.

Since we are presently in the process of evaluating the quality of prototype and pre-production parts, we have not yet formalized supplier contracts. However, as a result of this process, we are currently negotiating contracts with nearly 60 U.S.-based suppliers and in addition, will contract with another 140 domestic suppliers who will provide materials, utilities, and other products and services needed to operate our Kentucky plant.

Mr. Chairman, I am pleased to tell you that as a result of this extensive process, TMM will be procuring approximately $650 million annually worth of parts, materials and services from U.S. suppliers for our Kentucky operation.

From the beginning, our local content will be about 60 percent. Our initial parts suppliers will include companies from 14 States, concentrated in Kentucky, Indiana, Michigan, and Ohio.

Mr. Chairman, let me emphasize that this is what we expect to accomplish by the time we start production, but that is just the beginning and not the end of our commitment to U.S. sources.

Our search for U.S. suppliers is far from over. We are determined to increase our sourcing from U.S. suppliers as we gain greater experience in the United States.

As part of our continuing effort to maximize U.S. content, we will keep looking for domestic suppliers to provide items we have initially had to source offshore. We will work with potential suppliers. If they meet our standards, we will shift to them at the appropriate time, for example, when we have full design changes.

In order to fulfill this ongoing commitment, we are in the process of establishing a strong TMM purchasing department in the United States, with American managers and buyers who will be fully responsible for all U.S. procurement. More than 100 people, including personnel from inspection, production control, and related groups will work in the purchasing activity.

We are already beefing up our procurement staff in Southfield, Michigan and will be shifting these functions to Kentucky sometime this summer.

We are looking for suppliers who share our philosophy that the customer comes first. This means never compromising on quality or performance, and it means a willingness to place long-term success ahead of short-term profits. It means suppliers who establish production systems that assure built-in quality and a continued search for improvement.

In short, we are looking for good old-fashioned American initiative and ingenuity. And I am pleased to tell you that we are finding that enthusiasm and that competitive drive among American suppliers.

Mr. Chairman, we are committed to domestic sourcing to the greatest extent possible. We believe it makes good business sense for us. In the final analysis, increased domestic sourcing will take place through the good faith efforts and the hard work of TMM and the suppliers to forge a long-term business relationship based upon mutual trust and a common commitment to quality and competitiveness.

We believe we are off to a good start, and I can assure you that that effort will be unceasing.

Thank you.

[The prepared statement of Mr. Warren, with attachments, follow:]

Testimony of Alex M. Warren, Jr.

Vice President

Toyota Motor Manufacturing, U.S.A., Inc.

Lexington, Kentucky

Before the

Subcommittee on Employment and Productivity

of the

Senate Committee on Labor and Human Resources

March 30, 1987

Mr. Chairman, Members of the Subcommittee:

My name is Alex Warren. I am Vice President for Administration of Toyota Motor Manufacturing, U.S.A., Inc., known as TMM. TMM is the company that has been established to build automobiles at Toyota's $800-million auto plant under construction near Georgetown, Kentucky.

I welcome your invitation to testify today on TMM's progress and plans for U.S. procurement.

As you know, 14 months ago, Toyota announced it had chosen Kentucky as the site for its first wholly-owned U.S. auto plant. Today, we are in the midst of construction of our facilities near Georgetown, Kentucky. Construction of our plant is about 65% completed, and there are about 1,500 American construction workers on site. When construction peaks this summer, we expect that number to nearly double.

When we reach full production sometime in 1989, our Kentucky plant will produce 200,000 Camry models a year. We will directly employ about 3,000 people. All but about 50 will be American workers using Japanese and American know-how to produce high-quality American cars.

To place our procurement goals and activities in context, let me begin with a brief description of the basic concepts behind our management philosophy for TMM.

First, we want to combine the best of Toyota with the best of America in establishing a new business operation firmly based in the United States. We hope to contribute to the quality of life in the United States by providing Americans with the highest quality cars at reasonable prices.

Second, we want to contribute to the development of the Commonwealth of Kentucky and to the United States economy in general by providing capital resources, procuring parts and materials, transferring the very latest technology, expanding employment opportunities and increasing the pool of tax revenues.

Third, and most pertinent to your inquiry today, Toyota is firmly committed to maximizing U.S. content at the start-up of production and to increasing that content in the future. This will be done without compromising our product quality standards. U.S. procurement has distinct economic advantages in terms of lower transportation costs and more effective communications with suppliers. Local sourcing also is necessary for Toyota's well-known just-in-time production supply system.

For these reasons, when quality, cost and delivery flexibility are competitive, the ball will roll towards U.S. suppliers. We will give even stronger consideration to U.S. suppliers with strong engineering capabilities.

These basic principles have been embodied in our initial procurement activities. Let me describe those activities to you.

The parts supply selection process began many months ago. Toyota produced more than 1,000 drawings, a 1,500-page compiliation of specifications in English, and provided several hundred thousand dollars worth of sample parts for local suppliers to analyze. We conducted a preliminary survey of about 1,200 North American parts and materials suppliers, including all suppliers who had indicated a desire to do business with us. We then formed a study team of purchasing, engineering and production specialists, which visited 180 of these companies.

Since we are presently in the process of evaluating the quality of prototype and pre-production parts, we have not yet formalized supplier contracts. However, as a result of this process, we currently are negotiating contracts with nearly 60 U.S.-based parts suppliers. In addition, we will contract with another 140 domestic suppliers who will provide materials, utilities, and other products and services needed to operate our Kentucky plant.

Mr. Chairman, I am pleased to tell you that as a result of this extensive process, TMM will be procuring approximately $650 million annually worth of parts, materials and services from U.S. suppliers to our Kentucky operation.

From the beginning, our local content will be about 60%. Our initial parts suppliers will include companies from 14 states, concentrated in Kentucky, Indiana, Michigan, and Ohio. Among the companies with which we are in the final stage of negotiations are Sheller Globe of Toledo, Ohio; Van Dresser of Troy, Michigan; GM Delco Division of Dayton, Ohio; GKN of Southfield, Michigan; and GNB of St. Paul, Minnesota.

Let me briefly describe some of the roughly 500 parts which we will procure from domestic sources. They include:

- hard mechanical parts, including shock absorbers and disk wheels;
- electrical parts, such as batteries and wiper motors;
- console boxes, door trim and other items which are new in design and require new production methods;
- body related stamped parts and parts and components made of plastic;
- interior parts such as seats, carpet and headliners;
- exterior design parts such as radiator grill molding and rear-end panels;
- general use parts, such as tires and glass.

In addition, we will be conducting many production steps in-house at our Kentucky plant. These include body stamping and assembly, molding of plastic bumpers and instrument panels, painting and, of course, assembly of the vehicles.

Mr. Chairman, let me emphasize that this is what we expect to accomplish by the time that we start production. But that it is the beginning, not the end, of TMM's commitment to

U.S. sourcing. Our search for U.S. suppliers is far from over. We are determined to increase our sourcing from U.S. suppliers as we gain greater experience in the United States.

As part of our continuing effort to maximize U.S. content, we will keep looking for domestic suppliers to provide items we have initially had to source off-shore. We will work with potential suppliers. If they meet our standards, we will shift to them at an appropriate time, for example, when full design changes occur.

In order to fulfill this ongoing commitment, we are in the process of establishing a strong TMM Purchasing Department in the U.S. with American managers and buyers who will be fully responsible for all U.S. procurement. We intend to operate this Department in a way that combines the best Japanese procurement practices with the strongest features of the American system. More than 100 people, including personnel from inspection, production control and related groups, will work in this purchasing activity. Toyota already is beefing up its procurement staff in Southfield, Michigan, and we will be shifting these functions to Kentucky sometime this summer.

Mr. Chairman, it may be helpful to briefly describe what it is that TMM is looking for in its relationships with American suppliers.

We are looking for suppliers who share our philosophy that the customer comes first. This means never compromising on quality or performance. It means the willingness to place long-term success ahead of short-term profits. It means suppliers who establish production systems that assure built-in quality and the continued quest for improvement.

We are interested in building long-term relationships with our suppliers, based upon close two-way communication, with a continuing joint effort to improve our product.

We are looking for suppliers who can provide and maintain superior price competitiveness over the long-term by making their own necessary efforts to reduce costs.

We are looking for suppliers who are flexible enough in production and delivery to respond quickly to changes in a severely competitive market.

We are looking for suppliers who can develop parts by themselves in accordance with our basic requirements and who can evaluate them independently.

In short, Mr. Chairman we are looking for good old American initiative and ingenuity, and I am pleased to tell you that we are finding that enthusiasm and competitive drive among many American suppliers.

Mr. Chairman, we are committed to domestic sourcing to the greatest extent possible. We believe that makes good business sense. In the final analysis, increased domestic sourcing will take place through the good faith efforts and hard-work of TMM and suppliers to forge long-term business relationships based upon mutual trust and a common commitment to quality and competitiveness.

Our goal is to make TMM an outstanding American company, producing the highest quality product for the American people, in a true partnership with the people of Kentucky and a growing family of American suppliers. We believe we are off to a good start. I can assure you that that effort will be unceasing.

Thank you very much.

NEWS FROM
TOYOTA
Toyota Motor Manufacturing, U.S.A., Inc.
771 Corporate Drive, Suite 800, Lexington, Kentucky 40503

For Immediate Release

Following is a prepared text of remarks delivered by Alex Warren, vice president administration, Toyota Motor Manufacturing USA, Inc. at Chicago's Drake Hotel on February 5, 1987.

The plant will feature the finest technology. About half of our investment is targeted for equipment. Robots will perform some of the more undesirable jobs -- such as body welding and sealing -- freeing workers to control the machines, inspect the product, and do some of the fine-detail finishing work.

The building that will house this high technology is coming together right on schedule. As you may know, a number of issues with the construction unions have been settled and, overall, construction is about 65 percent complete.

It's a monumental effort to build Toyota Motor Manufacturing -- or TMM as we call it. Right now, there are about 1,500 construction workers on-site. And when construction peaks this summer, that number could double.

In contrast, just 20 minutes south of the plant site, a team of 30 TMM administrative people is busily developing the system for hiring the 3,000 Americans who will run our plant. And busy we are. The state of Kentucky already has received 41,000 applications for those 3,000 jobs and expects to process even more before we're completely staffed.

Currently, we're advertising for highly-skilled workers such as tool-and-die specialists and maintenance engineers. We expect to begin hiring that segment of our workforce this spring.

This spring, we'll also start advertising for production personnel in three categories; group leaders -- our name for supervisors; team leaders; and team members. We'll hire group and team leaders in the coming months, but we won't hire team members until early next year. That way we'll be able to send our group and team leaders to Japan for training so that they can help train the team members once they're hired.

Early in 1988, we'll begin pre-production build on the assembly line, working up to about 800 vehicles a day by the following year.

And that brings us to the sourcing of the parts and materials it will take to build those cars.

Alex Warren's Remarks

Toyota in Japan has directed us to maximize U.S. content at start-up and increase it in the future. And we share the same policy. Local procurement has distinct economic advantages in terms of lower transportation costs and more effective communication with suppliers. Local sourcing also is necessary for Toyota's well-known just-in-time production supply system.

For these reasons, the ball will roll toward U.S. suppliers when quality, cost and delivery flexibility are competitive. We'll give even stronger consideration to U.S. suppliers with good engineering capability.

The parts supplier selection process began many months ago. Toyota spent several hundred thousand dollars to produce more than 1,000 drawings, a 1,500-page compilation of specifications, and sample parts to accompany the request for quotes from prospective suppliers. We conducted a preliminary survey of about 1,200 firms. From that group, we picked about 180 and sent procurement teams to each company for closer examination. Finally, we selected nearly 60 firms for final evaluations.

Alex Warren's Remarks

While we expect to finalize all of our agreements in the near future, today I can name a few firms that are farthest along in the evaluation and negotiation process. I also can give you a good idea of how much U.S. sourcing we'll have.

All told, our U.S. sourcing of parts, materials and transportation should total about $650 million annually at start-up.

When the plant lines begin rolling, our local content should be about 60 percent. Counting the materials needed to keep the plant running, we expect to do business with 200 U.S. companies.

In addition, during construction, we plan to spend more than $400 million with 120 U.S. firms, including subcontractors.

Alex Warren's Remarks

Our parts partners will include companies from 14 states, centering on Kentucky, Michigan, Ohio and Indiana. Major parts among the 500 items they will supply include, for example, key chassis-related parts such as constant velocity joints; accessory items such as air conditioners and audio equipment; interior items such as carpeting and seats; electrical parts such as batteries, wiring harnesses and lamps; and general use parts such as glass and tires. Some of these components require sophisticated design and production technology as well as extensive testing and adjustments.

You might wonder just what we look for in a supplier. This relationship can best be described as one of close cooperation, common goals and mutual commitment to the same high quality standards.

But we're also looking at some subjective factors to help assure that we can do business through mutual trust and effort.

Alex Warren's Remarks

We're looking for suppliers willing to enter into a growth partnership with us. The key is a willingness to place quality and long-term success ahead of short-term profits. And, we're looking for suppliers whose production systems assure built-in quality. Their costs should be competitive on a long-term basis through constant improvements in efficiency. They must be flexible in production and delivery so they can adjust to changes in market demand. And they should be able to develop parts by themselves in accordance with our basic requirements and evaluate them independently. In short, good old American initiative and ingenuity.

Included among the suppliers being considered are top companies such as Sheller Globe of Toledo, Ohio; Van Dresser of Troy, Michigan; GKN of Southfield, Michigan; GNB of St. Paul, Minnesota; and GM Delco Division of Dayton, Ohio. The suppliers being considered are spread across a wide spectrum in terms of size and products. All of these suppliers have passed stringent checks by Toyota. They have a high potential to become suppliers for TMM.

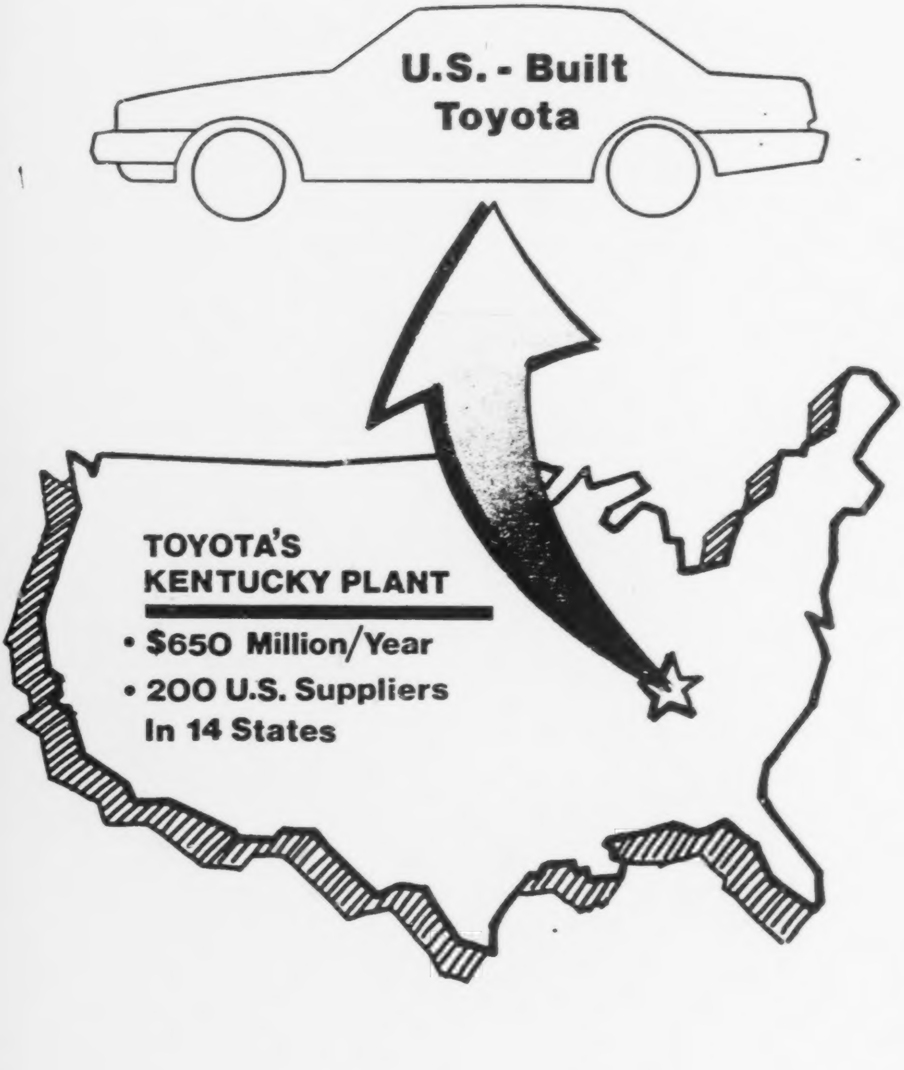
One final note. Although we've nearly completed the prototype sample evaluation process for 1988 start-up, the search for U.S. suppliers is not over. As part of our effort to maximize local content, we will keep looking for domestic suppliers to provide items we've initially had to source off-shore. We'll work with potential suppliers. If they meet our standards, we'll shift to them at an appropriate time.

Toyota has beefed up the staff at its Southfield, Michigan, purchasing office to pursue this objective and we'll form a large procurement division at TMM soon after production begins. A staff of 180 in Japan will provide support.

The people, the plant and our procurement plans are making great progress and we're very happy about it. We're even happier that Toyota and the U.S. are coming together. I can't think of a better partnership. And I firmly believe we can produce the best American car at TMM.

Thank you for your attention. Now let's take a few minutes for some questions.

# # #


U.S. - Built
Toyota
TOYOTA'S
KENTUCKY PLANT
• $650 Million/Year
• 200 U.S. Suppliers
In 14 States

TOYOTA MOTOR MANUFACTURING, U.S.A.

FACT SHEET

PLANT LOCATION - SCOTT COUNTY, KENTUCKY

INVESTMENT - $800 MILLION

TYPE OF CAR TO BE PRODUCED - CAMRY-CLASS 4 DOOR SEDAN

SCHEDULED ANNUAL PRODUCTION - 200,000 (2 SHIFTS)

PLANT EMPLOYMENT - 3,000

TOTAL SIZE OF FACILITIES - 3.7 MILLION SQUARE FEET

SCHEDULED COMPLETION - LATE 1987

CONSTRUCTION EMPLOYMENT (TO DATE) - 1,500

TOTAL CONSTRUCTION EMPLOYMENT - 3,500 + (BY SUMMER 1987)

PRE-PRODUCTION TRIAL BUILD - EARLY 1988

SCHEDULED START OF PRODUCTION - 1988

CONSTRUCTION STATUS OF STRUCTURES - ABOUT 65% COMPLETE (TO DATE)

ANNUAL PAYROLL (AT FULL EMPLOYMENT) - $85 MILLION

TMMPR:2/87

NEWS from TOYOTA

September 12, 1985 (No. 35-85)

For immediate release

Contact: Overseas Public Affairs, Tokyo
03-817-7873 (Mr. Kida)
03-817-7874 (Mr. Yamada)

(1985 plan to increase imports of U.S. goods for use at Toyota Motor Manufacturing, Japan)

TOYOTA'S "ACTION PROGRAM" FOR INCREASING IMPORTS

Toyota Motor Corporation began its import of automobile parts around 1972, and since then has posted purchasing experts in Europe and the United States and taken other steps to expand imports gradually while consolidating its import organization. And, in order to expand our imports in line with MITI's request, the company formed this spring the "Import Expansion Committee" (Chairman: Executive Vice President Hiroyasu Ono), which includes representatives from companies in the Toyota Group, and is undertaking a wide range of import expansion activities.

Toyota has brought together in the form of an Action Program the results of the Import Expansion Committee's deliberations. Plans call for imports from overseas for 1985 in the amount of 60 billion yen, 13 billion yen more than for 1984 (an increase of 28%).

A breakdown of these figures indicates that due to strong efforts by the related departments and the purchasing experts posted overseas, there will be an 11.6 billion yen increase over 1984 for the types of parts, materials, and equipment.

Also, soliciting a wide range of ideas for utilizing imported goods in new areas, with a view to expanding imports, resulted in over 300 suggestions. The suggestions acted on will lead to increased imports worth 1.4 billion yen. Among those which have materialized are, specifically, the purchase of helicopters, the import and marketing of American-made Toyota vehicles, the use of foreign goods as gifts and giveaways for sales promotion, and holding a number of Import Fairs at the Toyota Cooperative Store for sale of imported foods, housewares and other items.

For the Toyota Group as a whole, import figures are expected to reach 195.0 billion yen, an increase of 22.0 billion yen over 1984 (up 13%).

In addition, plans for 1986 and later include the import of large-size computers, the use of American ships for shipping parts to NUMMI (New United Motor Manufacturing Inc.) and

- more -

(2) Items Added to List for Import

1985: Helicopters
Toyota vehicles made in U.S.
Gift items and giveaway items for sales promotion
Items to be sold at following import fairs by Toyota Cooperative Store:
(a) Already carried out;
June: Fair for imported fruits
July - August: Summer gifts and imported products fair
August: Imported goods bargain sale
August: Toyota Summer Festival
September: Toyota Import Fair

(b) Coop Festival (Oct. 12 - 13)

(c) Others include winter sports goods fair in November and December, setting up a special display of import products for year-end gifts, and other import fairs.

1986 and later:
Large-size computers
Testing and research equipment, machine tools
Medical equipment for Toyota Hospital
Use of U.S. flag carriers for shipping parts, etc. to NUMMI in California

(3) Outline of Committee for Expanding Imports

Establishment: May 1985
Chairman: Executive Vice President Hiroyasu Ono
Vice Chairman: Senior Managing Director Tsutomu Ohshima
Secretariat: Director Junichi Sakurai (Office is in Corporate Planning Office)
Members: About 30 members from related divisions in TMC and from companies in the Toyota Group.

(4) Organizational Changes for Expanding Imports

* In 1974, the Administration Staff of the Purchasing Administration Department began formulating plans and proposals for expanding imports (in 1979, this work was transferred to the Overseas Parts Purchasing Staff of the Parts & Body Purchasing Department). Around the same time, purchasing experts were posted in our U.S. Office (New Jersey) to look for import items. This function was transferred to our Detroit Branch Office in February 1980.

Purchasing experts were also posted in our Europe Office beginning in 1976, and they also began making studies of items for possible import.

- more -

The current in-company structure related to imports is as follows:

Name of Group	Duties	No. of Members	Establishment
Purchasing Staff, Europe Office	This Group is the contact point between European manufacturers and TMC; duties include search for items and surveys of manufacturers	2	Nov. 1976
Overseas Parts Purchasing Staff, Parts & Body Purchasing Department	Search for new items to import; handling of import procedures	14	Feb. 1979
Purchasing Staff, Detroit Branch Office	This Group is the contact point between North American manufacturers and TMC; duties include search for items and survey of manufacturers	3	Feb. 1980
Overseas Administration, Administration Staff, Purchasing Administration Department	Overall contact point for overseas purchasing	5	Feb. 1985

(5) Principal Sources of Overseas Items TMC Importing

Country	Item	Company
U.S.	Carpet	Collins & Aikman Corp.
	Textile fabric	Chatham Manufacturing Co./ Milliken & Company
	Headlights	General Electric Co.
	Valve lifters	Rochester Products Div., General Motors Corp.
	Door lock actuator	Delco Products Div., General Motors Corp.
	Headlights	GTE Products Corporation
	Leather upholstery	Eagle Ottawa Leather Co.
	Disc brake pads	Allied Automotive, Bendix Friction Materials Div.
	Laminated glass	PPG Industries, Inc.
	Catalyst carrier	Corning Glass Works
Canada	Aluminum wheels	Canadian Auto Parts Toyota, Inc.
	Laminated glass	Duplate Div., PPG Canada Inc.
	Wiper blades	Tridon International
	Radial tires	Michelin Tires (Canada) Ltd.
U.K.	Tires	Pirelli Ltd.
France	Tires	Manufacture Francaise des Pneumatiques Michelin
W. Germany	Aluminum wheels	Intra, Fleischmann & Wacker GmbH
	Tires	Veith Pirelli AG
	Tires	Michelin Reifenwerke AG
	Clutch discs	Fichtel & Sachs AG
Austria	Tires	Semperit Aktiengesellschaft
Australia	Aluminum castings	Australian Motor Industries Ltd.
	Glass	Plkington ACI
	Seat belts	Repco Cooldrive Consolidated Industries
Belgium	Tires	Societe Belge du Pneumatique Michelin S.A.
Italy	Tires	Societa per Azioni Michelin Italiana
Spain	Tires	Sociedad para la Fablication En España De Neumaticos Michelin

* * *

FEB 26 1987

INTERIM REPORT ON MOSS TALKS ON TRANSPORTATION MACHINERY

The automotive industry worldwide is in a critical period of change. Its growing internationalization is led by the United States and Japan. Automotive trade and investment patterns are important to our national economies, and automotive trade is the largest component of our bilateral trading relationship. Both governments wish to resolve issues of automotive parts transactions which could affect the health of their respective automotive industries.

The following summarizes the progress that was achieved during the Transportation Machinery MOSS talks to date.

DEVELOPMENTS TO DATE

Since last August, four sets of talks have discussed ways to expand opportunities for U.S. and other foreign parts suppliers to enter the auto parts market for Japanese vehicles. Both governments are determined to conclude the talks by August 1987.

(Joint statement issued by U.S. and Japanese government after February round of MOSS talks on auto parts, Washington, D.C.)

Data Collection

Both the U.S. and Japanese governments recognize the importance of collecting relevant commerical data covering transactions between U.S. auto parts companies and Japanese vehicle companies. The Japan Automobile Manufacturers Association (JAMA) is currently considering how to collect such data with the encouragement of the Ministry of International Trade and Industry (MITI).

Some of the elements of data collection being considered by JAMA are: (1) annual data will be provided to cover Japan Fiscal Years 1985 and 1986, and semiannual data thereafter; (2) the data will cover purchases for use in the Japanese market and in the U.S. market; (3) the data will identify a reasonable number of categories of parts; (4) the data will include all parts, accessories and materials used in the production of motor vehicles; and (5) the data will be expressed in terms of dollar value of purchases with relevant exchange rate specified.

Identification of Contact Points for Parts Suppliers

In order to provide U.S. parts suppliers with easier sales access to Japanese automakers and their U.S. entities, the Japanese side prepared and submitted a list of specific purchasing department contacts at each Japanese automaker and its U.S. entities for their OE parts, replacement parts and accessories. The U.S. side disseminated the contact lists widely within the U.S. industry and encouraged U.S. suppliers to utilize it fully in their marketing efforts.

Trade Development

In order to facilitate automotive parts transactions between the United States and Japan, the Japanese government and Japanese automakers have been actively cooperating in seminars and trade shows on automotive parts, based on requests from the U.S. government and the U.S. auto industry, and they will continue to do so in the future. For example, the Japanese Government is facilitating U.S. participation in the 1987 Tokyo Motor Show and has agreed to support a major conference on selling automotive parts to Japanese vehicle manufacturers, to be held in Indianapolis on May 27 and 28.

Efforts by Japanese Automakers Regarding Import Expansion and Local Sourcing

The Japanese side has provided information regarding not only the efforts by Japanese automakers to expand imports of foreign parts but also those by Japanese automakers and their U.S. entities to expand local sourcing. Both sides hope these efforts will contribute to the greater sales opportunities for competitive U.S. and other foreign automotive parts through improved market access.

The Government of Japan has indicated that the Japanese vehicle manufacturers will give serious consideration to listing in their owners manuals foreign spark plugs adopted by them as OE parts.

Case Studies

Japan and the United States exchanged information regarding several cases of actual commercial contacts between U.S. auto parts suppliers and Japanese vehicle manufacturers which illustrated both generic difficulties and factors for success. Governmental examination of the facts in several cases led to a correction of misunderstanding and a resumption of commercial negotiations between the U.S. and Japanese firms.

Relations Between Automobile Manufacturers and Their Suppliers

The Japanese and U.S. sides exchanged views regarding relations between automobile manufacturers and their parts suppliers in each country. There are indications that their procurement policies are converging.

Japan's Periodic Inspection System

In order to clarify the fact that the Ministry of Transport's periodic inspection program does not discriminate against vehicles equipped with foreign automotive parts, the Government of Japan has decided to undertake a campaign to inform inspectors, and operators of maintenance and repair facilities, that the installation of foreign-made parts does not pose any obstacle to clearing the inspection.

U.S. Automotive Parts Office in Japan

Both governments indicated their strong support for the U.S. Auto Parts Industry's office in Japan which is to be opened in March 1987. The office is jointly funded by the U.S. Department of Commerce and the Motor and Equipment Manufacturers' Association (MEMA). The Japan Automobile Manufacturers' Association (JAMA) also fully supports the establishment of the office and has set up a contact point for better coordination.

CONTINUED EFFORTS

Combined with further efforts of the industries of both countries, both governments will continue to make mutual efforts towards the goal of an improved market environment for U.S. and other foreign automotive parts. The important tests of our accomplishments include a significant increase in sales by U.S. auto parts companies to Japanese vehicle companies and the initiation of long-term sourcing relationships between U.S. parts companies and Japanese vehicle companies.

NEWS FROM TOYOTA

Toyota Motor Manufacturing, U.S.A., Inc.
771 Corporate Drive, Suite 800, Lexington, Kentucky 40503

IMMEDIATE RELEASE

TOYOTA ANNOUNCES PARTS PROCUREMENT PLANS FOR KENTUCKY PLANT

CHICAGO, Feb. 5, 1987 -- Toyota will purchase more than $650 million worth of parts and services a year from U.S. suppliers for its Kentucky plant, a Toyota Motor Manufacturing, U.S.A., (TMM) executive announced here today.

Toyota will procure more than 500 items from U.S. firms, said Alex (Alec) Warren, Jr., TMM vice president - administration, including key chassis-related parts such as constant velocity joints; major accessory items such as air conditioners and audio equipment; interior items such as carpeting and seats; electrical parts such as batteries, wiring harnesses and lamps; and general use parts such as glass and tires. Some of these components will require sophisticated design and production technology as well as extensive testing.

"By the time we begin production in mid-1988, our local content should be about 60 percent," Warren said.

He noted that 200 companies, including nearly 60 parts suppliers, have been selected for the final evaluations that could make them suppliers for the $800-million Toyota plant being built near Georgetown, Ky. The companies range from small to large and manufacture a wide variety of products.

- more -

"The suppliers we're negotiating with extend over 14 states, with the greatest number located in Kentucky, Michigan, Ohio and Indiana," Warren said.

The TMM executive named several U.S. suppliers nearing final approval. The companies and their headquarters are: Sheller Globe of Toledo, Ohio; Van Dresser of Troy, Mich.; GM Delco Division of Dayton, Ohio; GKN of Southfield, Mich., and GNB of St. Paul, Minn.

"Toyota in Japan has directed us to maximize U.S. content at start-up and increase it in the future and we share the same policy," said Warren.

"Local procurement has distinct economic advantages in terms of lower transportation costs and more effective communication with suppliers. Local sourcing also is necessary for Toyota's well-known just-in-time production supply system. For these reasons, the ball will roll toward U.S. suppliers when quality, cost and delivery flexibility are competitive. And we'll give even stronger consideration to U.S. suppliers with good engineering capability."

Warren said that the parts supplier selection process began many months ago. Toyota spent several hundred thousand dollars to produce more than 1,000 drawings, a 1,500-page compilation of specifications, and sample parts to accompany the request for quotes from prospective suppliers. After making a preliminary survey of about 1,200 firms, Toyota selected nearly 60 parts firms for final evaluation.

- more -

"We're looking for suppliers willing to enter into a growth partnership with us," said Warren. "The key is a willingness to place quality and long-term success ahead of short-term profits."

Warren said that Toyota's search for U.S. suppliers will be an ongoing process.

"As part of our effort to maximize local content, we will continue our search for domestic suppliers to provide items we've initially had to source off-shore. We'll work with potential suppliers. If they meet our standards, we'll shift to them at an appropriate time."

Warren said that Toyota has beefed up the staff at its Southfield, Mich., purchasing office to pursue this objective and that a large procurement division will be formed at TMM soon after production begins. A staff of 180 in Japan will provide support.

"The people, the plant and our procurement plans are making great progress and we're very happy about it. We're even happier that Toyota and the U.S. are coming together. I can't think of a better partnership. And I firmly believe we can produce the best American car at TMM," he said.

# # #

Contact: Jeff Smith (606) 224-1110

Senator SIMON. We thank you, and we appreciate what you are doing to try and maximize American purchases here.

You have heard the testimony that preceded you here, I believe. Do you have any reaction to all of that?

Mr. WARREN. Yes, sir. I think that we have to realize the reality that we have had two separate systems supply industries for 30 or 40 years. And I think that we have to recognize that building bridges between those two is going to happen, and I believe that firms like Toyota, who have decided to put an American manufacturing operation into place in the United States and to work with American suppliers are going to continue to enhance that. We are finding this to be the case.

And I think that if you listen to the panel of suppliers, you heard their testimony that they are making progress, but it is critical to us that we have a quality product, that it be a low-cost product, that it have good delivery flexibility with our suppliers. These things are the essence of our business. And I believe that you heard that, that some of these suppliers are finding that they do very well with Japanese auto manufacturers, and I know for a fact that some of them are still on our list.

Senator SIMON. It would be interesting for the record—and I recognize you cannot do it here right now, and I do not want to be asking you to do something that may have complications for your business. But it would be interesting for the major parts suppliers if you could send us a list of who your American suppliers are—if Mr. Lehman's firm is providing gaskets, that kind of thing—so that we would see and we could take a look in the record at where we are going here.

Mr. WARREN. Let me clarify, Mr. Chairman, that certainly as a new company we have yet to establish the firm supplier contracts at this point. We have nearly 60 that are in the final process of evaluation, so we have not firmly established those relationships at this point.

Senator SIMON. So that if we could, say, six months from now, or at what point would you be in a position to do this?

Mr. WARREN. I would say that one of the issues that we have relates to the proprietary interest of this. We have spent, as we have indicated in the presentation, many thousands of dollars and do a lot of research to ascertain which are the best suppliers for Toyota Motor Manufacturing, and to some extent this is a proprietary issue for us, and that to reveal that for our competitors causes us a bit of a competitive edge. As much as we would like to cooperate with you, it does cause a problem in that regard.

Senator SIMON. Yes—I did not mean to suggest you do anything that might cause a problem.

You mentioned the 60 percent figure. Five years from now, where do you hope to be?

Mr. WARREN. Well, we are starting at the 60 percent, and as I indicated to you, that is our target. We are two years away from production. So we are going to continue to try to improve that. It makes good sense to us to have U.S. suppliers. The relationship that is so important to us for the Toyota production system is to have a very closeknit relationship where we exchange design information, and we are working together to improve the product, because we have to have a joint commitment with those suppliers.

So we are going to continue to cultivate that, and we are probably starting at one of the higher targets at this point, because I believe it has happened with other manufacturers, they have found suppliers, and these suppliers have learned to deal with Japanese manufacturers so they have become more acceptable. And I think this will continue, and we are just continuing to build those bridges.

Senator SIMON. I notice in your statement you say TMM will be procuring approximately $650 million annually worth of parts, materials, and services. "And services" means what?

Mr. WARREN. It can mean utilities, it could mean any number of items outside that have American value added to them. Probably 80 percent of those will be in the parts area, though.

Senator SIMON. Do the MOSS talks affect you in any way?

Mr. WARREN. No, sir, not directly, because TMM is an American company, and we are looking at it straight from the American side.

I have some personal views as far as that is concerned. I believe very strongly that it is going to take the good faith relationships, the good faith efforts of the suppliers and the foreign manufacturers working those issues out as we are doing. And we are very comfortable and very confident with the progress we have made thus far. But I think we are going to find that the quality and the production technology, together, as we work with our U.S. suppliers, that that is going to grow, and it is going to make the total auto parts industry and the automobile industry in the United States much more competitive in an international industry. This is an international industry that we are dealing with today, and we need to take whatever actions are necessary to be more competitive.

Senator SIMON. What if suddenly you are a United States Senator from Kentucky instead of involved in your plant. When you saw that $170 billion deficit, and you saw a $58 billion deficit with Japan, what would you be doing to try and turn things around?

Mr. WARREN. I think as far as the issues relating to that, I would encourage the U.S. suppliers to listen very closely and to work very closely with the Japanese manufacturers that are coming in here. It has not been too many years ago when the Japanese manufacturers were importing cars here, and the American industry said, "Come into the United States. Come over and play on our territory." That is beginning to happen now. And I believe the entire auto parts industry in the United States as well as the automobile industry is a much more competitive, vibrant entity today in the United States than it was several years ago, and I think it will continue to be, but I think it is going to have to be an issue that is worked out between the parts suppliers and the manufacturers. Good relationships are built through cooperative mutual efforts, not so much through force.

Senator SIMON. Maybe force is not the right word, but we need a nudge from government, I think; at least that is the opinion of many of us as we try and move ahead.

Any further thoughts you may have along that line at any point—and I say this to all the rest of you who are here, too—I do not know of any Member of the House or Senate who believes he or she has all the answers. We have a problem. And when I say "we" have a problem, it is the United States and Japan who jointly have a problem. And we ought to work it out so that we do not do harm to either country. We can work it out, I think, in such a way. But clearly, there will have to be changes in the present statistics, or Congress is likely to take action that may not be in the best interest of either country.

Mr. WARREN. I think the long-term competitive vitality of this industry is going to be increased if we continue to let it run as it is. I have heard a couple of comments from previous individuals who have testified regarding FTZ matters, relating them to import car manufacturers. The fact is that there are 41 automotive-related subzones—zones or subzones—in the United States. Thirty-three of those are with domestic manufacturers. So this is not an aberration of import car manufacturers. It is for us; it merely allows us to have the appropriate duty attached to the parts that we do have to bring into the United States and have them met with a tariff structure that is the same as if we imported the entire car.

But this is not an issue that is related to the import car companies because as I say, 33 out of 41 of those zones or subzones are with domestic manufacturers.

Senator SIMON. We thank you very, very much for your testimony and for your patience in addition to your testimony.

We will hold the record open for several days because there may be additional statements or questions that may want to be entered in the record, but the hearing stands adjourned.

[Additional material supplied for the record follows:]

STATEMENT OF STEVE BECKMAN, INTERNATIONAL ECONOMIST
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)
before the
SUBCOMMITTEE ON EMPLOYMENT AND PRODUCTIVITY
of the
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

March 30, 1987

Mr. Chairman, the UAW appreciates this opportunity to testify on the situation in the U.S. auto parts industry and the international economic forces that are affecting it. This industry is of vital importance to the industrial strength of the nation. We are extremely concerned by the changes already underway that, if allowed to continue, will mean the loss of hundreds of thousands of high-productivity, good paying jobs for American workers. A combination of international trade in auto products and the pattern of investment by U.S. firms and by foreign firms in the U.S. industry has created this unhealthy situation.

The auto industry in the 1980's has been subject to intense international pressures which will continue into the forseeable future. The market share for imported cars was 17.9 percent in 1978 and 28.3 percent in 1986. Sales of North American-built cars fell by nearly a million over this period despite an increase in total sales of almost 300,000 cars. The import share does not include the cars assembled in the U.S. by Japanese firms. Adding these low U.S. content vehicles would raise the import share to 33 percent.

The impact on UAW members has been tragic. Our auto industry membership fell by more than 200,000 between 1978 and 1986. By far the largest share of that decline was in the parts segment of the industry. UAW membership in that segment is down by almost 30 percent. Employment in the industry as a whole has dropped by about

400,000 since 1978, causing severe problems of dislocation and unemployment in communities across the country, but especially in the Midwest.

We would like to address one of the factors that is transforming the U.S. industry: the investment in U.S. auto production by foreign firms. This investment comes in two categories — new final assembly plants on the one hand and plants making auto parts on the other. Both types of investments affect U.S. parts industry employment and UAW membership. They are, in fact, related phenomena.

The decision of Japan's auto producing firms to establish North American assembly facilities was a response to political and economic pressures. The Voluntary Restraint Agreement (VRA) negotiated with the Japanese government in 1981 to limit auto exports to the U.S. and the domestic auto content legislation that passed the House in 1982 and 1983 were strong incentives to produce in the U.S. More recently, the appreciation of the value of the yen relative to the dollar has provided a financial incentive for Japanese firms to produce here. To date, plants built by Honda and Nissan are in operation and Mazda will soon begin production, while Toyota is a partner with General Motors in the NUMMI operation. Other plants involving Toyota, Mitsubishi, Fuji Heavy Industries (maker of Subarus) and Isuzu are under construction or nearly there, while Suzuki and Daihatsu will be part of joint ventures setting up plants in Canada.

New capacity to build more than two million cars for the North American market will have been added when all these plants are operating. We anticipated that the cars produced at these plants would replace imports from Japan. So far, this has not been the case. Imports from Japan have increased dramatically since 1978 and there is no indication that Japanese firms are planning to cut back their exports to the U.S. as their U.S.-production expands. The obvious result of such a development will be the closing of existing U.S. assembly plants as more of the new plants ("transplants") begin to turn out cars. The job losses accompanying these closings will be serious.

The impact on the U.S. parts industry will be equally traumatic. The new plants with foreign ownership import a very large proportion of the parts assembled into their cars. The most highly engineered and most complex parts are almost entirely sourced abroad (the only major exception is Honda's decision to build engines in the U.S.). The few such plants already in operation helped send the value of U.S auto parts imports from Japan up by 42 percent from 1985 to 1986. The parts sourced in the U.S. have been those made primarily of materials that are cheaper here (aluminum, plastics) and parts that are hard to ship because of their size (seats). It is generally agreed that less than 30 percent of the value of the parts assembled into transplant vehicles is sourced in the U.S.

A significant proportion of the U.S.-made parts assembled into transplants are made in new plants set up by the Japanese auto companies' traditional Japanese suppliers. The new U.S. assemblers have chosen to keep up their long-standing supplier relationships rather than fully open their parts purchases to U.S. suppliers. Many U.S. parts companies have complained about their inability to receive a fair opportunity to present a competitive proposal to the transplant producers.

Just as the new assembly plants are creating excess capacity in the U.S. market, so the new parts plants are creating the potential for a large number of plant closings and the dislocation of the present parts industry workforce. The unnecessarily heavy reliance of the new foreign operations on imported materials and components is also contributing to U.S. job losses and the worsening U.S.-trade balance.

The replacement of traditional domestically produced cars with low-U.S. content transplants could result in the loss of 200,000 jobs in the parts and materials supplier industries when all the new plants are operating. The vehicles being replaced contain approximately 95 percent U.S. parts by value. A plant making these vehicles provides employment for about 25,000 parts and supplier industry workers; a transplant operation generates only about 6,700 related jobs. This difference makes it possible for U.S. auto industry employment to fall substantially, even as the number of cars assembled in the U.S. remains constant.

The Market-Oriented Sector-Specific (MOSS) talks on transportation machinery were proposed to remedy the potential loss of U.S. auto parts jobs. The U.S. objective in the negotiations is to raise the purchases of U.S. auto parts by Japanese auto makers in their home market and in the U.S. This effort was supported by the UAW and many others as a way to prevent the loss of jobs in the parts industry due to the changes in the industry discussed in this hearing. We are deeply disturbed by the lack of progress in the talks. The joint report issued at the half-way point in the one year negotiating period indicates that the important issues we wanted to be addressed are not yet on the table.

The UAW believes that the U.S. and Japanese negotiators must agree on specific objectives for increased purchases of U.S. auto parts if the talks are to be judged a success. We want to see: higher U.S. content in the U.S.-assembled vehicles of Japanese firms and their joint ventures with U.S. producers; increased U.S. exports to Japan of parts for the original equipment and replacement markets, and; expanded use of U.S.-made parts for the servicing and repair of Japanese cars in the U.S. Our concerns in these areas are spelled out in greater detail in the attached letter sent to Secretary of Commerce Baldrige in February.

Unfortunately, the Commerce Department has become entrapped in discussions of how to measure U.S. sales to Japanese companies rather than the need to set a goal for the increase of those sales. We are afraid that this MOSS negotiation is headed in the same direction as previous negotiations with Japan: an agreement will be reached, success will be proclaimed and no improvement in the trade situation will result. There is still time for Congress and the private sector to insist on a meaningful agreement, but time is growing short.

Mr. Chairman, the prospects for employment and production in the auto parts industry are not encouraging. The foreign investment we have sought has, as yet, been insufficient to preserve the strength of the parts industry. Foreign firms are relying too much on continuing high levels of imports of both vehicles and parts. Without a healthy parts industry, the auto industry is merely a hollow shell lacking an essential building block of industrial dynamism. It will take renewed efforts to force the MOSS negotiations to adequately respond to the U.S. industry's problems. The passage of tough, effective trade legislation that recognizes the immediate need to reduce the tremendous U.S. trade deficit is a necessary foundation for defending the U.S. auto industry.

Thank you, Mr. Chairman for providing this opportunity to state the UAW's views on the situation of the auto parts industry.

opeiu494

dd40

ob human resources

Statement
of
Nissan Motor Manufacturing Corporation U.S.A.

to the

Subcommittee on Employment and Productivity

Labor and Human Resources Committee

United States Senate

April 10, 1987

Nissan Motor Manufacturing Corporation U.S.A. ("NMMC") is a subsidiary of Nissan Motor Co., Ltd., of Japan and constitutes Nissan's entry into the automotive manufacturing business in the United States. NMMC is located in Smyrna, Tennessee, near Nashville.

The Company was incorporated in July 1980. Manufacturing operations began in June 1983 with the production of Nissan pickup trucks. In June 1985, production of passenger cars was added. The Company is now building passenger cars and pickup trucks at a rate of 265,000 units annually on two shifts. The Company's capital investment has grown to $848 million.

NMMC appreciates this opportunity to submit comments for the record of the hearing of the Senate Employment and Productivity Subcommittee on the MOSS talks and on the relationship between foreign direct investment and employment in the automotive industry.

The MOSS Talks and NMMC

The relationship to our Company of the automotive parts negotiations between the U. S. and Japanese governments is a puzzle to us. Although owned by a Japanese parent, NMMC is an American company incorporated under the laws of the State of Delaware. Management of the Company is in the hands of American citizens. For all practical and legal purposes, the Company is a United States person.

Yet, instead of talking to NMMC's management, officials of the U. S. Department of Commerce have initiated discussions with the Government of Japan concerning the affairs of our U. S. Company. Commerce officials have asked officials of the Japanese Government why a certain American parts company has been unable to win business from us. They have asked the Japanese government to provide the Department of Commerce with data on our purchases of auto parts from other American companies. We find this somewhat peculiar.

If the U. S. Government has questions about the activities of our Company, why is it asking a foreign government for the answers? Why not ask us? We have afforded the Commerce Department several opportunities to discuss directly with us whatever concerns they may have, but they have chosen not to do so. The Commerce Department's position in this matter seems to be at odds with long-standing U. S. Government policies toward foreign direct investment in the United States, as well as with U. S. insistence on national and nondiscriminatory treatment for U. S. foreign direct investment overseas.

Although our understanding of what is transpiring in the MOSS talks is indirect, it is clear that at least in part the issue under discussion concerns the procurement of parts by our Company. We hope that this description of our procurement policy, our procurement process, and our experience to date will shed light on this matter for the Subcommittee.

NMMC Procurement Policy

Our Company's management team in Tennessee selects suppliers for the parts we buy. Our procurement policy is straightforward. We source on the basis of three criteria: quality, cost and timeliness of delivery. The research and development capabilities of candidate suppliers have also become important because they can provide much of the engineering and quality support needed to adapt local parts to our vehicles.

The fact that the vehicles we build are also being built by Nissan Motor Co., Ltd., means that all the parts we need are already being produced somewhere else--mainly in Japan. But that does not mean U. S. companies cannot supply us. In fact, we have a mandate from the Chairman and the President of Nissan in Japan to source as much as we can in the United States. However, we also have mandates to match or exceed the quality of vehicles built in Japan--which we are doing--and to make a profit--which we are not, yet. This means the quality of parts American companies offer us must be as good as the quality we are getting from Japan--or better. Cost has to be lower. And we must be assured of timely delivery.

National or corporate origin is of no consideration to us in choosing suppliers. It can't be. The notion that so-called "family relationships" dictate our sourcing decisions is, to be blunt, ridiculous. The competition in our industry is global and it is intense. We can't afford to base parts procurement decisions on non-economic criteria. We would not survive doing business that way. As a result, we now buy parts from suppliers in Japan, the United States, Canada and Mexico, and we will soon be buying parts made in the Philippines. We will buy from any supplier that best meets our criteria.

We have an "open door" policy toward all parts suppliers. We make every effort to meet with any supplier company that shows up on our doorstep, even unannounced. And we will schedule a meeting with any supplier who requests one.

NMMC's Procurement Process

Parts sourcing recommendations are made to our management team by the Company's "Local Sourcing Task Force." The Task Force is composed of representatives from the six departments in the Company most concerned with parts procurement: Product Engineering, Production Purchasing, Supplier Quality

Assurance, Process Engineering, Production Control and Finance. The Task Force has a mandate to source every part it can locally.

At the beginning of each fiscal year, the Task Force reviews all parts being sourced in Japan to establish priorities among them for sourcing elsewhere. Priorities are established on the basis of possible cost savings, difficulties encountered in shipping, ease of manufacturing and other factors. Once priorities are established, target introduction dates for the new supplier are set, and manpower and budget resources are allocated to support the sourcing plan.

The Product Engineering staff prepares specifications and drawings or other data related to the parts to be sourced, and the Purchasing staff provides target prices for them. "Requests for Quotes" are then sent to a number of candidate suppliers. Candidates are selected from among the many supplier companies with whom we have had contact since beginning operations, as well as from current suppliers and others who may be known to our staff from previous automotive experiences. This preliminary selection process is essential. To illustrate, we have more than 300 stamped parts to source, and we have had contact with more than 250 stamping companies. To evaluate all of them for each part would make it impossible to make a sourcing decision within any acceptable timeframe. In the case of a stamping study recently completed, for example, we requested quotes from 13 companies which represented a cross-section of the 250 suppliers known to us.

With more difficult projects, we meet with prospective suppliers at the time our "Requests for Quotes" are issued in order to insure that the suppliers fully understand our needs and can prepare realistic bids. Once supplier bids are analyzed by the Purchasing staff, the detailed product prices as well as the investment needed for tooling (since we will own the tooling) is forwarded to our Finance Department for financial analysis. That analysis is studied by the Local Sourcing Task Force along with several other factors, and the list of potential suppliers is narrowed, usually to several "approved" candidates.

We then visit the candidates for an intense design and manufacturing evaluation. Our evaluation team makes surveys in the areas of product engineering and quality assurance to evaluate the extent to which each candidate firm is likely to be able to meet our selection criteria of quality, price and delivery, and the extent to which each can provide research and development assistance. We assign quantitative scores for quality control capabilities to each company. Generally, one final candidate is then selected.

Depending on the part being sourced, we may require that prototype samples be submitted for testing. We also conduct laboratory testing and field testing. For example, our Product Engineering staff and mobile lab have just returned from Florida where we conducted extensive hot weather testing on several rubber components and shock absorbers. And recently, we completed the field testing of "fuel filler hoses" in the corporate fleets of our own company and Nissan Motor Corporation in U.S.A., the California company which distributes our products.

At the end of this extensive process, the Local Sourcing Task Force reviews the information gathered. A draft recommendation paper is prepared by the Purchasing staff which presents all the evaluations that have been made. Each department on the Task Force expresses its approval or disapproval of the recommended supplier. When consensus is reached, the recommendation paper is presented to management for approval.

From the time that Product Engineering prepares the specifications and drawings for parts to be let out for bid until a recommendation is submitted to management, anywhere from three to twelve months may have elapsed, depending on the complexity of the part being sourced and the extent of the testing required. Hundreds of man hours have been expended in evaluation and analysis. Our Company's goal is to produce the highest quality vehicles sold in North America. There are no shortcuts to that goal.

NMMC's Experience with U. S. Automotive Suppliers

The Company's experience with U. S. producers of automotive components is extensive, and it is continually growing. Since beginning operations, our Company has initiated contact with more than 400 U. S. suppliers. Another 1,800 have taken the initiative to contact us. We are currently doing business with 104 U. S. suppliers of production parts, and the annual value of our commitments to them exceeds $475 million. In the six months since we testified before this subcommittee in September 1986, we have made commitments to 12 additional U. S. suppliers and the total value of our commitments has grown by nearly $100 million.

Our experience in six years of assessing automotive parts suppliers tells us that there are competitive U. S. producers. The 104 American companies with which we are doing business (including fourteen subsidiaries of Japanese firms) took that business away from suppliers in Japan, including our parent company. In addition to these 104 companies, we have "qualified" other firms. Even though these firms were judged competitive, they didn't win our business because they weren't the very best in the particular bid selection they participated in. We hope to find other parts that we can invite these firms to bid on.

We are very "bullish" on American companies--companies like Bendix, Calsonic Manufacturing, Johnson Controls and PPG Industries. They were rated among our top quality suppliers in 1986. We recently ran a full page ad in Automotive News honoring them and our other top suppliers. We fully intend to work with them as partners on a long-term basis to even further improve their quality and productivity.

Over the past two years, the competitiveness of U. S. supplier firms has improved substantially as the falling value of the dollar has caused significant cost increases in Japan-sourced parts. Indeed, the fall in the dollar's value from 260 to almost 150 yen implies an enormous shift in relative costs.

That shift has created a tremendous opportunity for U. S. companies for two reasons. It has improved their price position relative to firms in Japan, and it has greatly increased our Company's motivation to accelerate sourcing to firms in the United States. Many companies that could meet our quality and delivery requirements before, but were not cost competitive, should now be able to meet all our sourcing criteria--and they will get our business.

Not every American company that has knocked on our door has been able to demonstrate that it could meet our quality, cost and delivery requirements, however. Many cannot. In our judgment, they simply have not been competitive in producing the particular parts on which they have sought to bid.

Moreover, even some firms that we select as suppliers disappoint us. Despite our extensive evaluations to select only truly qualified suppliers, our Company has taken on a number of U. S. automotive parts suppliers--absolutely convinced they could do the job--only to find out through unhappy experiences that they could not. These experiences have been few in number, but they have been traumatic. In each case, we have had to resource parts. In some cases, the business has gone to other U. S. suppliers. In others, it has gone back to Japan.

We keep a close watch on the defect rates of all our components. This is one good indicator of quality. Our recent experience is summarized in a chart attached to my statement. It demonstrates that the defect rates of our U. S. suppliers for the last six months of 1986 were consistently higher than those of our Japanese suppliers--and, as far as we're concerned, ours are the very best U. S. parts companies. But we intend to get the defect rates down by working closely with our suppliers--all of our suppliers--in a diligent attempt to improve their quality and ours. We must, because our corporate objective is to build the highest quality vehicle sold in North America--and that means buying the highest quality parts.

In conclusion, there are companies in the U. S. industry that are striving for and achieving excellence. There are others that have the potential to be competitive--but whether they will fulfill that potential is an open question. And there are other U. S. firms that have little potential and seem to be striving only to encourage government intervention to enable them to obtain business they cannot win in an open, competitive environment.

Our experience makes us incredulous when we hear self-serving boasts about the competitiveness of the U. S. auto parts industry. For us, assessing competitiveness is a company-by-company, product-by-product process. Competitiveness can be proved only in the testing lab, in the finance department, on the production line, in the auto dealer's showroom, and--ultimately and conclusively--in the hands of the consumer. It cannot be proved in press releases or in hearing rooms.

Impact of Foreign Investment on Employment

The relationship between foreign direct investment and employment is a complex one that we cannot address in all its dimensions here. American industry, including U. S. automobile and automotive parts companies, has been the world's largest foreign direct investor for many decades. Although the United States has become a net debtor country as a result of borrowing foreign capital to finance domestic budget deficits, the stock of U. S. foreign direct investment continues to far exceed the value of foreign direct investment in the United States. While arguments have been advanced that U. S. foreign direct investment has adverse effects for the U. S. and foreign economies, the preponderance of evidence suggests that on balance foreign direct investment has net beneficial effects, including employment effects, in both "home" and "host" countries.

The employment impact of Nissan's investment in our Company is both direct and indirect. We directly employ 3,300 people in our Tennessee facility. We are purchasing production parts from 104 U. S. parts suppliers and the value of our purchasing commitments to them is now $475 million annually. We purchase non-production supplies and materials valued at more than $125 million annually from scores of other U. S. companies.

Estimating the indirect employment effects of our purchases of production parts and non-production supplies is difficult. We believe a conservative estimate is that these purchases support 10,000 U. S. jobs. Our conclusion, then, is that the U. S. employment supported by our operations in Tennessee exceeds 13,300 Americans. That employment effect is clearly positive. A separate question is whether the net impact of our operations, taking into account the possibility that our production would displace existing U. S. production, is also positive.

The argument is made that foreign direct investment, such as Nissan's investment in our Company, has a net negative impact on U. S. employment because the vehicles we produce--estimated to have a U. S. content of about 58 percent--have a lower U. S. content level than the vehicles they are "replacing," assumed to be vehicles produced by traditional U. S. firms--alleged to have a U. S. content of about 90 percent.

Two plainly erroneous assumptions underlie this argument.

The first is that the vehicles we produce "replace" sales that otherwise would have been made by traditional domestic firms. That assumption requires critical examination. An important question is: are the vehicles produced by new entrant companies replacing vehicles that otherwise would have been produced by traditional domestic firms, or are they replacing vehicles that would otherwise have been imported? Given the dynamics of the U. S. automotive market, there is good reason to believe that these vehicles would have been imported, if not from Japan because of the VRA, then from Korea or other countries.

In this circumstance, the valid comparison is not between the U. S. content of the vehicles we produce and the vehicles traditional U. S. firms produce, but between the vehicles we produce and imports with virtually no U. S. content. The employment implications of that are clear. The operations of our Company have a net positive impact on U. S. employment.

The second erroneous assumption concerns the local content assumed in the vehicles produced by our Company and other new entrants, and the domestic content of the vehicles produced by traditional domestic firms. These assumptions understate our U. S. content and in our judgment exaggerate the U. S. content (as opposed to North American content) of Big Three production.

The total U. S. content levels of the vehicles we are now producing is 58 percent. The U. S. parts content of those vehicles is 30 percent and we have made commitments to U. S. suppliers that will bring the level to 37 percent in the near future. We do not know the U. S. content of the non-captive imports produced by the Big Three, but our judgment is that the 90 percent level often cited significantly overstates the true content levels.

Moreover, the trend in our production is to increase U. S. content levels. We are now aggressively seeking U. S. suppliers to provide parts that will bring the parts content of the vehicles we produce to 60 percent. The trend of the Big Three producers is toward declining, not increasing, U. S. content. It is not unreasonable to expect that within three years NMMC's U. S. content will match that of the Big Three.

The question of the employment impact of foreign investment in the U. S. automotive industry seems to have arisen in the context of fears that a condition of overcapacity is developing in North American automotive production. That itself is an interesting proposition to analyze. Overcapacity is essential for there to be real competition in the marketplace. If capacity falls below demand, a "seller's market" exists. Prices to consumers rise and manufacturers have little incentive to improve products or service. Competition deteriorates. Producers reap windfalls but consumers and the economy lose. Only if there is overcapacity can there be significant competition: the opportunity for consumer choice that puts downward pressure on prices and provides an incentive for manufacturers to excel.

The traditional notion of excess capacity is arrived at by adding up the number of vehicles that an industry is capable of producing and comparing it with anticipated demand. If the former exceeds the latter, a condition of overcapacity is deemed to be imminent. That is a very simplistic approach. If we had the capacity to produce 15 million horse-drawn buggies a year, the statistic would be meaningless because there is no market for horse-drawn buggies.

A better way to approach the concept of capacity is to think in terms of competitive versus obsolete capacity. Obsolete capacity--which can arise from an obsolete facility that lacks automation and controls to build products with quality and productivity, obsolete work practices that undermine productivity and quality, or obsolete product--is not capacity at all. It is simply a drain on costs.

The facts of the marketplace--continually rising vehicle prices, increasing imports of vehicles and components from both traditional and new foreign suppliers, and growing foreign direct investment--clearly demonstrate that the United States is significantly under capacity in the category of competitive capacity. Imports and new entrant manufacturers are creating competition that traditional manufacturers, long protected in an oligopolistic market, find uncomfortable. This competition, while painful for some, is a net benefit to the United States economy.

Senator SIMON. Thank you.

[Whereupon, at 4:30 p.m., the Subcommittee was adjourned.]

○